



# Local Agency Investment Guidelines: Update of 2007 Statutory Changes and Consensus Recommendations

(Reflects State Law Changes Effective as of January 1, 2007)

# Local Agency Investment Guidelines: Update of 2007 Statutory Changes and Consensus Recommendations

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## CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

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The California Debt and Investment Advisory Commission was created in 1981 to assist state and local governments to most effectively and efficiently issue, monitor and manage public debt. In 1995, the Commission's responsibilities were expanded to include a municipal education program to help local governments to safely and effectively invest public funds. To carry out its responsibilities, the Commission maintains a database of all public debt issued in California, conducts a continuing education program, publishes a monthly newsletter with debt issuance data and informative articles, and conducts research to develop reports, guidelines and briefs on topical issues related to public debt issuance and investment practices.

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## SUMMARY OF STATUTORY CHANGES

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The California Debt and Investment Advisory Commission (CDIAC) has annually revised its *Local Agency Investment Guidelines* to include statutory changes that affect local government investments. However, the subjects addressed in the interpretive sections have not been updated to any meaningful extent since 1996. As such, in late 2006 CDIAC convened a working group consisting of investment professionals that developed the revisions reflected in this publication.

This document also reflects changes and additions to the California Government Code effective January 1, 2007. These changes include the following:

Sections 27008 (b) and 27009: These sections have been revised to clarify that alternate procedures may be established to permit the treasurer to receive or deposit money without the certificate of the auditor, and allows for the treasurer to receive money directly without the auditor's involvement.

Section 53601.7 (e)(6)(B) and 53635 (a)(3): These subdivisions (applicable to a local agency that is a county or a city and county, or that pools with other local agencies) have been revised to remove the requirement that eligible commercial paper may not represent more than 10 percent of the outstanding commercial paper of a single issuing corporation.

Section 53601.7 (i): This subdivision has been revised to extend the sunset date of January 1, 2007 to January 1, 2011 for permissible investments under Section 53601.7.

Sections 53601.8 and 53635.8: These new sections authorize, until January 1, 2012, the investment of up to 30 percent of a local agency's surplus funds in certificates of deposit at a commercial bank, savings bank (savings and loan association), or credit union that uses a private sector entity that assists in the placement of certificates of deposit under specified conditions.

Sections 53635(a)(2): This subdivision has been revised to state that no more than 10 percent of the total investments held by a local agency may be invested in any one issuer's commercial paper (formerly, this section stated that 10 percent of a local agency's money may be invested in the outstanding commercial paper of any single issuer).

Section 53646 (g): This subdivision, which requires the submittal of copies of investment reports to the California Debt and Investment Advisory Commission within 60 days after the close of the second and fourth quarters of each calendar year, is inoperative effective January 1, 2007.

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## INTRODUCTION

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The aftermath of the 1994 Orange County investment pool bankruptcy prompted numerous reports, special hearings, and committees to assess what went wrong and suggest measures to avoid similar problems in the future. These activities culminated in the California Legislature's enactment in late 1995 of numerous changes to the Government Code that restricted permissible investments and promoted oversight procedures for the management of public funds.

There was widespread support for the objectives of these new investment laws; however, many local officials expressed uncertainty over their implementation. To address these concerns, in 1996, the then-California Debt Advisory Commission (the "Commission") brought together a "working group" of interested parties to prepare what became the Commission's *Local Agency Investment Guidelines* (the "*Guidelines*").

The *Guidelines* were developed as an interpretive document meant to aid local officials in their efforts to implement the new laws. Since the original report's release in 1996, numerous statutory changes have occurred, including the addition of providing investment education and research to the Commission's statutes. As a result, the Commission's name was changed to the California Debt and Investment Advisory Commission (CDIAC). In keeping with its expanded mandate, CDIAC has annually revised these *Guidelines* to include statutory changes that have occurred since 1996. However, the "consensus recommendations" included in the *Guidelines* have not been updated since 1996 to address changes in statute or practices reflective of the current public fund investment environment.

In December 2006, CDIAC convened another working group of public- and private-sector public finance industry professionals to revise and update the consensus recommendations. All participants of the working group agreed with or had no strong objections to the consensus recommendations found in the *Guidelines*. The participants were:

CDIAC Technical Advisory Committee members:

- Constantine Baranoff, Attorney, Kronick Moskovitz Tiedemann & Girard
- Bill Blackwill, Senior Vice President, Citigroup Global Markets, Inc.
- Ned Connolly, Vice President, Chandler Asset Management, Inc.
- Joya De Foor, City Treasurer, City of Los Angeles
- Tony Garcia, Vice President, Wells Fargo IBS
- Deborah Higgins, President, Higgins Capital Management

Representing California local government associations:

- Rod Dole, Auditor-Controller/Treasurer-Tax Collector, County of Sonoma (California Association of County Treasurers and Tax Collectors)
- Pauline Marx, Chief Assistant Treasurer, City and County of San Francisco (California Society of Municipal Finance Officers)
- Laura Parisi, CPA, CCMT, City Treasurer, City of Laguna Beach (California Municipal Treasurers Association)

The coordination of the working group and the writing was by:

- Barbara Tanaka, Research Program Specialist, CDIAC
- Kristin Szakaly-Moore, Director of Policy Research, CDIAC

This updated document retains much of the same format as the original document. It briefly describes each of the issues considered, offers an interpretation of the minimum legal requirement for compliance with the applicable section of the law, and provides consensus recommendations developed by the 2006 working group. These interpretations represent the best judgment of the investment professionals involved, and are intended only as guidance for local agencies in their efforts to comply with the laws. Local agencies are advised, therefore, to rely only upon their legal counsel for legal advice.

The *Guidelines* are divided into four chapters:

Chapter I.	The Annual Investment Policy
Chapter II.	Fund Management
Chapter III.	Reporting Requirements
Chapter IV.	Treasury Oversight Committees

There is one issue that does not fit neatly into one of these four chapters, and this concerns the applicability of statute to different types of jurisdictions. Generally speaking, it was the consensus of the original working group that all local agencies, regardless of their characterization, are subject to the reporting, fund management, and investment policy requirements. (Only county governments are potentially subject to the county oversight committee requirements.) These requirements are contained in California Government Code Section 53600, which states:

*As used in this article, "local agency" means a county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.*

Any jurisdiction that assumes it is not covered by these provisions should seek the advice of its legal counsel.

The updated *Guidelines* also provide valuable information on how to properly manage public funds; however, it is also important to note that nothing can substitute for proper education/training of local agency treasurers, investment officers, and members of the legislative body/advisory committees in the area of public investments. In addition to this report, CDIAC offers investment seminars to provide local officials with relevant information to assist them with their responsibilities and has numerous publications available on its website ([www.treasurer.ca.gov](http://www.treasurer.ca.gov)) that cover various topical areas of public fund investments.

CDIAC would like to thank the members of the working group mentioned above for contributing a considerable amount of professional expertise and time, and for their conscientious efforts towards revising the final *Guidelines*.

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## CHAPTER I. THE ANNUAL INVESTMENT POLICY

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A good investment policy encompasses the cash, treasury, and investment management functions of an agency. It serves as a guide for setting and achieving program objectives, defines rules and establishes benchmarks, and reduces the exposure to liability of both the investment staff and the governing board. Finally, it is also important to note that rating agencies pay close attention to an agency's investment policy and portfolio in determining its credit rating.

### **I. A. Should local agencies produce an investment policy? Should the investment policy be presented to the local agency's legislative body? [Section 53646(a)]<sup>1</sup>**

The investment policy serves as the foundation of a local agency's investment goals and priorities. If the investment policy is carefully researched, effectively drafted, and reviewed regularly to assure that it continues to meet the agency's goals/priorities for its portfolio, it can help protect the assets of the organization. The existence of an approved investment policy demonstrates that the governing body is fiducially responsible, thereby, promoting trust and confidence from the public that it serves.

*Minimum legal requirements:* Section 53646(a)(1) states that the treasurer of a county government may annually render to his/her board of supervisors and oversight committee an investment policy, which the board shall review and approve at a public meeting. In addition, the board shall review and approve any changes to the investment policy at a public meeting.

Section 53646(a)(2) states that the treasurer or chief fiscal officer of any other local agency may annually render to his/her legislative body and any oversight committee an investment policy, which the legislative body shall consider at a public meeting. This raises questions about whether or not the policy should be adopted officially by the legislative body, and the time during the year that this "consideration" should take place.

*Consensus recommendation:* An investment policy should always be in place. While no longer required by statute, it is in the best interest of the local agency to present and discuss the policy with the agency's legislative body and/or oversight committee, and then have the policy approved by a vote of the legislative body. A public vote signifies that the legislative body shares fiduciary responsibility with the treasurer, increases the authority and legitimacy of the investment policy, and provides transparency and disclosure.

### **I. B. When should the investment policy be reviewed and updated? How should the investment policy be rendered to the legislative body? [Section 53646(a)]**

The size and complexity of the investment policy, portfolio, agency and the agency's staff are factors that may affect the frequency of the investment policy review and revision.

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<sup>1</sup> All "Section" references refer to the California Government Code unless otherwise noted.

*Minimum legal requirement:* If submitted to the local agency's legislative body, the investment policy must be an agenda item at a public meeting. If submitted, the county board of supervisors is required to review and approve the investment policy and any changes to it at the public meeting. The statute does not place the same specific approval requirements on other local agencies, but it does require consideration. Statute does not specify, however, when during the year that consideration or approval should occur.

*Consensus recommendation:* Both the Association of Public Treasurers of the United States & Canada and the Governmental Finance Officers Association have established policy standards recommending the review be conducted annually. At a minimum, the internal treasury staff should conduct a review annually. Ideally, the review should be timed to coincide with the end of the State legislative cycle so that consideration may be given to any changes in statute that may impact the agency's policy.

An update in the investment policy is warranted if treasury staff's review results in a material change in policy due to either a change in statute or a change in the agency's goals and objectives for safety, liquidity and yield. A change in statute, however, may not necessarily require a change in the policy. Many agencies' policies are already more restrictive than statute. Likewise, an agency may choose to update its policy to restrict the purchase of a new investment product that is allowable by statute but that the agency deems to be too risky for its investment portfolio.

Although rendering the investment policy to the legislative body and/or oversight committee is not required, it is highly recommended. This should be done annually, on an established schedule, such as after the annual review and update.

For newly-elected legislative body members, election terms may not coincide with the investment policy review. As such, because of the fiduciary responsibility of the legislative body, any newly-elected members should be made aware of the existence of the investment policy and its contents as soon as possible.

## **I. C. What information should be included in the investment policy? [Section 27133]**

*Minimum legal requirements:* Except for county governments, the California Government Code does not contain any provisions specifying what must be included in the investment policy of a local agency. County investment policies must contain:

- A list of securities or other instruments in which the county treasury may invest, according to the law, including the maximum percentage by type of security, and the maximum term of any security purchased;
- The manner of calculating and apportioning the authorized costs of investing, depositing, banking, auditing, reporting, handling, and managing of funds;

- Limits on the receipt of honoraria, gifts, and gratuities for county treasury oversight members from advisors, brokers, dealers, bankers, or other persons with whom the county treasury conducts business;
- Criteria for selecting brokers and dealers (including prohibitions against selecting any broker, dealer, or security firm within any consecutive 48 month period of making a campaign contribution exceeding the limitations contained in Rule G-37 of the Municipal Securities Rulemaking Board);
- A requirement that the treasurer provide the county treasury oversight committee with an investment report as required by the Board of Supervisors;
- Terms and conditions under which other local agencies that are not required to deposit funds may deposit funds in the county treasury if they so choose; and
- Criteria for considering requests to withdraw funds from the county treasury.

The last two of the above elements directly refer to the duties counties have in maintaining a local government investment pool.

*Consensus recommendation:* Although statute does not specify requirements for other local agencies (other than counties), they should include the first five elements required by statute of counties in their investment policies. In addition to elements contained in statute, the policy should specify the funds to which the policy will and will not apply. For instance, bond proceeds are usually guided by the bond documents and thus, may not be a part of the investment policy. Similarly, pension funds are guided by other code sections and have different investment objectives.

A sample guide to creating an investment policy published by the Association of Public Treasurers of the U.S. and Canada is included in the Appendix of these *Guidelines* that gives additional details on items to include in an investment policy. The Government Finance Officers Association also has a sample investment policy available for purchase. Additional sources for recommended elements that are useful for including in an investment policy can be found in CDIAC's *California Public Fund Investment Primer* and *Investment Policy Reporting Practices: An Informational Guide*. These two publications can be found at <http://www.treasurer.ca.gov>.

#### **I. D. What constraints can county pools place on voluntary depositors? [Section 27133(g)]**

An area where questions commonly occur is how county pools should treat funds from voluntary depositors. Voluntary funds are often referred to as "hot money" because of the difficulty county treasurers have in predicting withdrawals of these funds. Failure to have adequate information on a depositor's cash flow can lead to unanticipated withdrawals and introduce potential liquidity problems.

*Minimum legal requirement:* State law does not require county pools to accept voluntary deposits.

*Consensus recommendation:* Allow voluntary deposits only under a clearly written contract or memorandum of understanding. This agreement should spell out the exact rules for participating in the pool and provide the county treasurer with reasonable predefined discretion to establish the frequency and amount of voluntary funds that can be removed from the pool at a particular time. Another option is to ban voluntary deposits altogether, if the county has confidence that other local agencies have reasonable investment alternatives.

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## CHAPTER II. FUND MANAGEMENT

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For the investment of county funds in a county treasury, Government Code Section 27000.3 establishes the Board of Supervisors as a fiduciary that is subject to the prudent investor standard unless it delegates its investment duties to the county treasurer. For other local agencies' funds invested in the county treasury, the county treasurer serves as a fiduciary and is subject to the prudent investor standard.

Except as provided for in Section 27000.3, Government Code Section 53600.3 declares each person, treasurer, or governing body authorized to make investment decisions on behalf of local agencies to be a trustee and therefore a fiduciary subject to the prudent investor standard. These persons shall act with care, skill, prudence, and diligence under the circumstances then prevailing when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. Section 53600.5 further stipulates that the primary objective of any person investing public funds is to safeguard principal; secondly, to meet liquidity needs of the depositor; and lastly, to achieve a return or yield on invested funds (Government Code Section 27000.5 specifies the same objectives for county treasurers and board of supervisors).

Risk is inherent throughout the investment process. There is risk assigned to any investment activity as well as opportunity risk related to inactivity. Market risk is derived from exposure to overall changes in the general level of interest rates while credit risk is the risk of loss due to the failure of the issuer of a security. The market value of a security varies inversely with the level of interest rates. If an investor is required to sell an investment with a five percent yield in a comparable seven percent rate environment, that security will be sold at a loss. The magnitude of that loss will depend on the amount of time until maturity.

Purchasing certain allowable securities with a maturity of greater than five years requires approval of the governing board (see Government Code Section 53601). Part of that approval process involves assessing and disclosing the risk and possible volatility of longer-term investments.

Another element of risk is liquidity risk. Instruments with unique call features or special structures, or those issued by little known companies, are examples of "story bonds" and often are thinly traded. Their uniqueness often makes finding prospective buyers in a secondary market more difficult and, consequently, the securities' marketability and price are discounted. However, under certain market conditions, gains are also possible with these types of securities.

Default risk represents the possibility that the borrower may be unable to repay the obligation as scheduled. Generally, securities issued by the federal government and its agencies are considered the most secure, while securities issued by private corporations or negotiable certificates of deposit issued by commercial banks have a greater degree of risk. Securities with additional credit enhancements, such as bankers acceptances, collateralized repurchase agreements and collateralized bank deposits, are somewhere between the two on the risk spectrum.

The vast majority of portfolios are managed with a buy and hold policy. Investments are purchased with the intent and capacity to hold them until maturity. At times, market forces or operations may dictate swapping one security for another or selling a security before maturity.

Continuous analysis and fine tuning of the investment portfolio are considered part of prudent investment management.

This strategy is not to be confused with heavy trading activity where securities are purchased with the intent to sell them before maturity at a profit or the use of leverage to enhance yield. Such strategies require predicting the future direction of interest rates.

The Government Code contains specific provisions regarding the types of investments and practices permitted after considering the broad requirement of preserving principal and maintaining liquidity before seeking yield. These provisions are intended to promote the use of reliable, diverse, and safe investment instruments to better ensure a prudently managed portfolio worthy of public trust.

## **II. A. Which investments are permissible? Which are prohibited?**

**[Sections 16429.1, 53601, 53601.6, 53601.7, 53601.8, 53635, 53635.2, 53638, and 53684]**

*Minimum legal requirement:* Local agencies may invest only in those instruments specified in State law.

Government Code Sections 16429.1, 53601, 53601.6, 53601.7, 53601.8, 53635, 53635.2, 53638, and 53684 include a number of requirements on how and where public money may be invested. Figures 1 and 2 provide a synopsis of the permitted securities and conditions for using them.

Prohibited investments include securities not listed in Figures 1 and 2, as well as inverse floaters, range notes, interest only strips derived from a pool of mortgages, and any security that could result in zero interest accrual<sup>2</sup> if held to maturity, as specified in Section 53601.6.

*Consensus recommendation:* Include the list of permissible securities in the investment policy, and modify the list to meet the unique needs of the local agency. These modifications may include additional restrictions on the type and amount of specific authorized investments to reflect the risk tolerance of the agency.

Some investments, such as straight floaters or floating rate notes that are not otherwise prohibited have the potential to result in zero interest accrual. Before purchasing these types of investments, the local agency should evaluate all possible outcomes, and as a safeguard, might consider including in its investment policy a statement establishing an acceptable positive spread or floor for all investments.

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<sup>2</sup> Zero interest accrual means the security has the potential to realize zero interest depending upon the structure of the security. Zero coupon bonds and similar investments that start at a level below the face value are legal because their value does increase.

**Figure 1**  
**Allowable Investment Instruments**  
**Per State Government Code (as of January 1, 2007)<sup>a</sup>**  
**Applicable to All Local Agencies<sup>b</sup>**

Investment Type	Maximum Maturity <sup>c</sup>	Maximum Specified Percentage of Portfolio <sup>d</sup>	Minimum Quality Requirements
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
State of California Obligations	5 years	None	None
CA Local Agency Obligations	5 years	None	None
U.S. Agencies	5 years	None	None
Bankers' Acceptances	180 days	40 percent <sup>e</sup>	None
Commercial Paper – Select Agencies <sup>f</sup>	270 days	25 percent of the agency's money <sup>g</sup>	"A-1/P-1/F-1"; if the issuer has issued long-term debt it must be rated "A" without regard to modifiers <sup>h</sup>
Commercial Paper – Others Agencies <sup>i</sup>	270 days	40 percent of the agency's money <sup>j</sup>	"A-1/P-1/F-1"; if the issuer has issued long-term debt it must be rated "A" without regard to modifiers <sup>h</sup>
Negotiable Certificates of Deposit	5 years	30 percent <sup>k</sup>	None
CD Placement Service	5 years	30 percent <sup>k</sup>	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements and Securities Lending Agreements	92 days <sup>l</sup>	20 percent of the base value of the portfolio	None <sup>m</sup>
Medium-Term Notes <sup>n</sup>	5 years	30 percent	"A" rating
Mutual Funds and Money Market Mutual Funds	N/A	20 percent <sup>o</sup>	Multiple <sup>p,q</sup>
Collateralized Bank Deposits	5 years	None	None
Mortgage Pass-Through Securities	5 years	20 percent	"AA" Rating <sup>r</sup>
Bank/Time Deposits	5 years	None	None
County Pooled Investment Funds	N/A	None	None
Joint Powers Authority Pool	N/A	None	Multiple <sup>s</sup>
Local Agency Investment Fund (LAIF)	N/A	None	None

See "Table of Notes for Figure 1" on page 11 for footnotes related to this figure.

## Table of Notes for Figure 1

- a. Sources: Government Code Sections 16429.1, 53601, 53601.8, 53635, and 53638.
- b. Municipal Utilities Districts have the authority under the Public Utilities Code Section 12871 to invest in certain securities not addressed here.
- c. Government Code Section 53601 provides that the maximum term of any investment authorized under this section, unless otherwise stated, is five years. However, the legislative body may grant express authority to make investments either specifically or as a part of an investment program approved by the legislative body that exceeds this five year maturity limit. Such approval must be issued no less than three months prior to the purchase of any security exceeding the five-year maturity limit.
- d. Percentages apply to all portfolio investments regardless of source of funds. For instance, cash from a reverse repurchase agreement would be subject to the restrictions.
- e. No more than 30 percent of the agency's money may be in Bankers' Acceptances of any one commercial bank.
- f. "Select Agencies" are defined as a "city, a district, or other local agency that do[es] not pool money in deposits or investment with other local agencies, other than local agencies that have the same governing body."
- g. No more than 10 percent of agency's money may be invested in any one issuer's commercial paper.
- h. Issuing corporation must be organized and operating with the U.S. and have assets in excess of \$500,000,000.
- i. "Other Agencies" are counties, a city and county, or other local agency "that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body." Local agencies that pool exclusively with other local agencies that have the same governing body must adhere to the limits set for "Select Agencies," above.
- j. No more than 10 percent of the of the agency's money may be invested in the Commercial Paper of any one corporate issuer.
- k. No more than 30 percent of the agency's total funds may be invested in CDs authorized under Sections 53601.8, 53635.8, and 53601 (h) combined.
- l. Reverse repurchase agreements or securities lending agreements may exceed the 92-day term if the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity dates of the same security.
- m. Reverse repurchase agreements must be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state chartered bank that has a significant relationship with the local agency. The local agency must have held the securities used for the agreements for at least 30 days.
- n. "Medium-term notes" are defined in Government Code Section 53601 as "all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating with the U.S. or by depository institutions licensed by the U.S. or any state and operating within the U.S."
- o. No more than 10 percent invested in any one mutual fund.
- p. A mutual fund must receive the highest ranking by not less than two nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of \$500 million, and has at least five years experience investing in instruments authorized by Government Code Sections 53601 and 53635.
- q. A money market mutual fund must receive the highest ranking by not less than two nationally recognized statistical rating organizations or retain an investment advisor registered with the SEC or exempt from registration and who has not less than five years experience investing in money market instruments with assets under management in excess of \$500 million.
- r. Issuer must have an "A" rating or better for the issuer's debt as provided by a nationally recognized rating agency.
- s. A joint powers authority pool must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of \$500 million, and has at least five years experience investing in instruments authorized by Government Code Section 53601, subdivisions (a) to (n).

**Figure 2**  
**Allowable Short-term Investment Instruments**  
**Per State Government Code (as of January 1, 2007)<sup>a</sup>**  
**Applicable to Counties or a City and County**

Investment Type	Maximum Maturity <sup>b</sup>	Maximum Specified Percentage of Portfolio <sup>c</sup>	Additional Quality Requirements <sup>d</sup>
U.S. Treasury Obligations	397 days	None	None
U.S. Agencies	397 days	None	None
State of California Obligations	397 days	5 percent in any one issuer	None
CA Local Agency Obligations	397 days	5 percent in any one issuer	None
Bankers' Acceptances	180 days	5 percent in any one issuer	None
Commercial Paper	270 days	5 percent in any one issuer	None <sup>e</sup>
First Tier Securities	N/A	Up to 25 percent of the total assets of investments	None
Negotiable Certificates of Deposit	397 days	5 percent in any one issuer <sup>f,g</sup>	None <sup>h</sup>
CD Placement Service		30 percent <sup>g</sup>	
Repurchase Agreements <sup>i</sup>	1 year <sup>j</sup>	None	None
Reverse Repurchase Agreements and Securities Lending Agreements <sup>i</sup>	92 days <sup>k</sup>	20 percent of the market value of the portfolio <sup>l</sup>	None <sup>m</sup>
Debt Securities Issued by Corporation or Depository Institution <sup>n</sup>	397 days	5 percent in any one issuer	None
Mutual Funds <sup>o</sup> and Money Market Mutual Funds	N/A	10 percent in any one mutual fund	Multiple <sup>p</sup>
Contracts Issued by Insurance Companies <sup>q</sup>	397 days	5 percent in any one issuer	None
Mortgage and Collateral-backed Securities <sup>r</sup>	397 days	5 percent in any one issuer	"AA" Rating <sup>s</sup>
SEC Rule 2a-7 Allowable Investments	397 days	5 percent in any one issuer	None

See "Table of Notes for Figure 2" on page 13 for footnotes related to this figure.

## Table of Notes for Figure 2

- a. Source: Government Code Sections 53601.7 and 53601.8
- b. A county or city and county may not invest in any security under Section 53601.7 that would cause the dollar-weighted average maturity of the funds in the investment pool to exceed 90 days.
- c. Percentages apply to all portfolio investments regardless of source of funds. For instance, cash from a reverse repurchase agreement would be subject to the restrictions.
- d. Unless otherwise specified, all corporate and depository institution investments must meet or exceed the following criteria at the time of purchase: 1) Short-term debt must be rated at least A-1, P-1, F-1; 2) If the issuer of short-term debt has issued long-term debt, the long-term debt must be rated "A" or better without respect to modifiers. Because Section 53601.7 does not define these investments, local agencies should consult with their legal counsel to determine if any investments purchased fall within this category.
- e. Issuing corporation must be organized and operating within the U.S. and have assets in excess of \$500,000,000.
- f. Subject to the limits placed on depository funds specified in Government Code Section 53638.
- g. No more than 30 percent of the agency's total funds may be invested in CDs authorized under Sections 53601.8, 53635.8, and 53601 (h) combined.
- h. Eligible certificates must be issued by a nationally or state-chartered bank or a federal association, or by a state-licensed branch of a foreign bank. Investments in certificates of deposit are subject to certain restrictions on conflicts of interest as specified in Section 53601.7(e)(7).
- i. Repurchase agreements, reverse repurchase agreements, or securities lending agreements must meet the delivery requirements specified in Government Code Section 53601.
- j. A security underlying a repurchase agreement or a reverse repurchase agreement may exceed the 397-day term limit placed on all investments allowed under Government Code Section 53601.7.
- k. Applies to reverse repurchase agreements unless the agreement includes a guarantee return for the entire period of the agreement.
- l. Value of portfolio based upon investments owned and does not include securities subject to other agreements, such as securities lending agreements.
- m. Investments in reverse repurchase agreements or similar investments can be made only with the approval of the governing body of the local agency and only with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a "significant banking relationship" with the local agency. The local agency must have held the securities used in the agreement for at least 30 days.
- n. Includes securities specified as "medium-term notes" issued by corporations organized and operating within the U.S. or by depository institutions licensed by the U.S. or any state and operating within the U.S.
- o. The investments in securities and obligations made by the mutual fund must conform to Government Code Section 53601.7 except that the counterparty to a reverse repurchase agreement is not required to be a primary dealer of the Federal Reserve Bank of New York if the company's board of directors finds that the counterparty presents a minimal risk of default.
- p. Must receive the highest ranking by not less than two nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC or exempt from registration, has assets under management in excess of \$500 million, and has at least five years experience investing in money market instruments.
- q. These include guaranteed investment contracts.
- r. Category includes mortgage pass-through security, collateralized mortgage obligation, mortgage-backed and other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bonds.
- s. Issuer must have an "A" rating or better for the issuer's debt as provided by a nationally recognized rating agency.

## II. B. What requirements must financial institutions satisfy before a local agency may deposit its money in it? [Section 53635.2]

Government Code Section 53635.2 states that all local agency money may be invested in investments set forth in 53601 or deposited for safekeeping in state or national banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies in this state. It also specifies certain requirements that such financial institutions must satisfy to hold local agency money.

*Minimum legal requirement:* To be eligible to receive local agency money, the financial institution must receive an overall rating of not less than "satisfactory" from the appropriate federal supervisory agency for meeting the criteria specified in Section 2906 of Title 12 of the U.S. Code (Community Reinvestment Act of 1977). The Community Reinvestment Act of 1977 requires financial institutions to demonstrate their commitment to meeting the credit needs of local communities in which they are chartered to do business. For the purpose of the Act, the appropriate federal supervisory agency includes:

- The Comptroller of the Currency with respect to national banks;
- The Board of Governors of the Federal Reserve System with respect to state chartered banks that are members of the Federal Reserve system and bank holding companies;
- The Federal Deposit Insurance Corporation (FDIC) with respect to state chartered banks and savings banks that are not members of the Federal Reserve system and the deposits of which are insured by the FDIC; and
- The Director of Office of Thrift Supervision with respect to savings associations (the deposits of which are insured by the FDIC) and savings holding companies.

A local agency would need to contact the appropriate federal supervisory agency to determine if its financial institution meets the overall rating requirement.

*Consensus recommendation:* Local agencies should be aware that in some instances ratings from federal supervisory agencies may not be current, as financial institutions are evaluated only every year or two. Additional inquiry may be necessary to obtain updated information if the last published rating is more than one year old.

## II. C. When must the composition and credit rating of investments contained in a local agency investment portfolio be in compliance with state law? [Sections 53601 and 53601.7]

The Government Code provides a description of the types of instruments permissible for local agency investment and specifies the timing of compliance with state law.

*Minimum legal requirement:* Where the Government Code specifies a percentage restriction on a certain category of investment, this share of the investment portfolio must be in compliance with state law at the time that investment is purchased. The law does not specify that the *entire*

portfolio must be in compliance when new instruments are purchased. It also does not require "rebalancing" in the case where subsequent maturities, sales, withdrawals, or similar non-purchase activities result in the remaining portfolio having one or more of the categories of investment rise above the percentage restrictions applicable at the time of purchase.

In addition, Government Code Section 53601.7 specifies (for investments purchased pursuant to this section) that any credit rating downgrade of an investment subsequent to purchase shall result in the security being reviewed for possible sale within a reasonable amount of time after the downgrade.

*Consensus recommendation:* The portfolio must be in compliance with statute at the time that the investment is purchased. It is recommended that the portfolio be monitored, as practical, for subsequent changes in percentages resulting from non-purchase activity or changes in credit rating of existing securities.

In the event the portfolio or individual investments are deemed to be out of compliance with either statute or the investment policy, the local agency should have procedural guidelines in place that outline actions to take under various scenarios. Due to its fiduciary responsibility, early communication with and involvement of the legislative body concerning a major or critical event is of utmost importance. Therefore, the procedural guidelines should identify circumstances under which communication and discussion of the treasurer's analysis and recommended course of action to the legislative body and/or oversight committee is warranted.

## **II. D. Must bond proceeds be invested in code cited securities? [Section 53601(l)]**

Section 53601(l) allows greater flexibility with respect to the types of investments that may be made with bond proceeds. Specifically, the law permits money from bond proceeds, obligations under a lease, installment sales, or other agreements of a local agency to be invested in any security that meets the statutory provisions governing the issuance of the bond or other agreements made by the issuing agency. In so doing, this section of the code recognizes that outstanding contracts between issuers and bond holders may not comply with the investment statutes, and gives local agencies greater discretion in how to invest bond proceeds.

*Minimum legal requirement:* Bond proceeds may be invested in accordance with Government Code provisions, or they may be invested in alternative vehicles if authorized by bond documents.

*Consensus recommendation:* The agency's investment policy should either require that bond proceeds be invested in accordance with the Government Code, reference applicable bond documents (such as, the indenture or rating agency requirements), or specify the types of investments authorized for bond proceeds. Bond proceeds may be invested in instruments with maturities longer than 5 years; thus, applying the 5-year maturity limitation found in statute may result in loss of yield.

## II. E. Are all U.S. Agency bonds legal for investment by California local agencies? [Sections 53601(e)]

There has been a lot of discussion about the risky nature of certain products and derivatives issued by U.S. Agencies. These Agencies offer both traditional fixed-income securities (notes and bonds) as well as other more complex, often-customized products (including derivatives). The State's investment laws, however, place no restrictions on these types of investments other than the prohibitions against inverse floaters, range notes, interest-only strips derived from mortgage pools, and securities that could result in zero-interest accrual if held to maturity. Therefore, local agencies may invest in a range of securities, including derivatives, issued by U.S. Agencies.

In recent years, some U.S. Agency debt has been privatized and is now structured like corporate debt yet still falls under the category of Agencies obligations. The most commonly traded U.S. government-sponsored enterprise (GSE) debt include the Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB), Federal Home Loan Mortgage Corporation (Freddie Mac), and Federal National Mortgage Association (Fannie Mae). Other less common GSEs include Government National Mortgage Association (Ginnie Mae) Community Development Corporation (CDC), Student Loan Marketing Association (Sallie Mae)<sup>3</sup>, Small Business Administration (SBA), and Tennessee Valley Authority (TVA).

*Minimum legal requirement:* Obligations, certificates of participation, or other instruments issued by a federal agency or a U.S. GSEs are permissible investments, subject to the prohibition against inverse floaters, range notes, interest-only strips derived from a pool of mortgages, and securities that could result in zero-interest accrual.

*Consensus recommendation:* Local agencies should institute restrictions that recognize the different characteristics of U.S. Agency bonds. Factors such as the size of the issue, prominence of the issuer in the market, and the complexity of the issue (such as call features or other options) will impact the risk level and thus, the rate of return that the local agency will receive. Investments in these types of products should only be entered into with a clear awareness, by both the legislative body and treasurer, of the risks involved and only if the local agency's staff has sufficient expertise to manage such investments.

## II. F. What are "medium-term notes?" [Sections 53601(j)]

Until recently, the Government Code simply defined medium-term notes as those instruments meeting certain term-length and quality requirements. Amendments to Government Code Section 53601(j) have attempted to clarify some of the ambiguity surrounding this definition. A variety of reasons account for this past confusion. One is that the SEC treats "corporate notes" slightly differently than "medium-term notes." Another is that brokers often refer to corporate obligations that have an original term to maturity longer than five years as corporate rather than

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<sup>3</sup> SLMA terminated its ties to the federal government in 2004; bonds issued prior to 2005 are GSE and rated Aaa/AAA; bonds issued 2004 and after are corporate debt rated A2/A.

medium-term notes, even though the present term to maturity for these notes may be less than five years.

*Minimum legal requirement:* Government Code Section 53601(j) defines medium-term notes as "all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating in the United States." Therefore, investments in any corporate or medium-term notes which mature within five years from the time of purchase are legal as long as they meet the minimum quality standards. Moreover, the Government Code specifies that local agencies may not classify investments as medium-term notes if they satisfy the definition of other allowable investments authorized under state law. For example, a local agency could not consider a security that satisfies the definition of commercial paper as a medium-term note in its portfolio.

*Consensus recommendation:* With many companies operating worldwide, the interpretation of the phrase "organized and operating in the United States" comes into question. While not clearly defined, local agencies should establish a method of determining whether a purchase of medium-term notes meets this requirement in consultation with their legal counsel. The following provides some general guidance and recommendations to consider:

- If an issuing entity is incorporated in the U.S., but is a subsidiary of a foreign-owned parent company the stability of either the parent company or the economy of the country of the parent company should be considered when purchasing from these types of entities.
- Alternately, a local agency may hold securities in a U.S. company that is subsequently purchased by or merges with a foreign company (for example, Chrysler Corporation's merger with Daimler Benz to form Daimler Benz Chrysler Corporation). The local agency should monitor the merger or purchase to determine if it remains a prudent security for the agency to hold.
- Determining the venue for any legal recourse in the event of a bankruptcy or credit event would assist the local agency in determining whether the organization is organized and operating in the U.S. If the security is backed by assets that are in the U.S., then the investor may attempt to attach a claim on them in a U.S. court in the event of a bankruptcy or default. If the security is not backed by assets, then the initial financing documents of the underlying security provide a possible source to assist with determining the legal venue.

## **II. G. What are the rules regarding the use of reverse repurchase agreements and securities lending agreements? [Sections 53601(i)]**

The intent of the investment laws in this area is to limit the opportunity for the imprudent use of reverse repurchase agreements (reverse repos) and securities lending agreements. In 1995, the Legislature, concerned about the use of reverse repurchase agreements for enhancing yield, imposed a number of restrictions on local governments. In 2002, the Legislature provided additional short-term investment options for a county or city and county government.

*Minimum legal requirements:* Government Code section 53601(i) imposes the following restrictions on reverse repos:

- Reverse repos cannot constitute more than 20 percent of the "market value" of an agency's portfolio;<sup>4</sup>
- Reverse repos are limited to 92 days unless the minimum spread between the rate on investment and cost of funds is guaranteed in writing; and
- Securities used to make reverse repos must be held for a minimum of 30 days prior to the transaction.

Government Code Section 53601(i) also applies the above restrictions to securities lending agreements with the exception that a local agency portfolio may not hold more than 20 percent of its base value in reverse repos and securities lending agreements combined.

For local agencies that purchase securities lending agreements under Government Code Section 53601.7, portfolios are not limited in the amount of securities lending agreements that they can hold (with the general exception that no more than 5 percent of a portfolio may be invested in any one issuer).

*Consensus recommendation:* Reverse repurchase agreements and securities lending agreements may be used to take advantage of certain short-term opportunities to increase yield as well as to resolve cash flow shortages. Reverse repurchase agreements should be used primarily for resolving cash flow shortages, and should be entered into only when there is a clear awareness by both the legislative body and treasurer of the risks involved, and when the agency's staff has sufficient expertise to manage such investments. The working group did not make any recommendations regarding securities lending agreements.

## II. H. What are the rules regarding the use of mutual funds and money market funds? [Sections 53601(k), 53601.6(b), and 53601.7(e)(10)]

*Minimum legal requirement:* The requirements under Government Code Section 53601 for investing in these funds are explained in Figure 3. The important distinction made between these two types of funds is that money market funds are not subject to the specific investment limitations of California Government Code Section 53601, while mutual funds are subject to those restrictions and local officials must verify their compliance prior to purchasing shares. Money market funds are governed by federal SEC regulations that specify diversification requirements and the types of securities that they may purchase. Money market funds are only authorized to invest in highly-rated, short-term debt instruments, but they may invest in certain ancillary agreements related to eligible securities (e.g., repurchase agreements, securities lending agreements, certain kinds of puts, etc.) that may carry a higher degree of risk. Because money market funds can only invest in securities with defined maturities, they cannot invest in equities or foreign currencies.

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<sup>4</sup> For reverse repos purchased under Government Code Section 53601, the calculation is based upon the "base value" of the agency's portfolio, which is defined as the dollar amount obtained by totaling all cash balances in the portfolio from all sources, excluding any amounts attained from reverse repos or similar borrowing methods.

For local agencies investing under Government Code Section 53601.7, similar requirements apply with the exception that mutual funds must invest in securities and obligations described in 53601.7.

*Consensus recommendation:* The investment policy should specify criteria for selection of both mutual funds and money market funds by the investment official.

**Figure 3:  
Government Code Requirements for Local Agency Investment  
in Money Market and Mutual Funds**

Conditions Allowing for Investment	Money Market Funds	Mutual Funds
I. Receive the highest ranking or the highest letter and numerical rating by no less than two nationally recognized rating services; <b>Or</b> Retain an investment advisor who is registered or exempt from registration with the SEC and has at least five years experience investing in specified securities and managing assets in excess of \$500 million. <sup>1</sup>	✓	✓
II. Abide by the same investment restrictions and regulations that apply to public agencies in California [Section 53601 (a-j, m-n)].		✓
III. Follow regulations specified by the SEC under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1, et seq.).	✓	

<sup>1</sup>The requirement for mutual funds is an investment advisor with experience investing in securities and obligations authorized in Section 53601 and 53635 of the Government Code. For money market funds, it is experience in managing the types of investments that can be purchased by money market funds as specified in SEC Regulation 2a-7.

## II. I. What are the rules affecting the use of tax and revenue anticipation notes (TRANs)? [Sections 53821.5, 53841.5, 53852.5 and 53859.02(b)]

The intent of the Government Code Sections listed is to prevent agencies from using their TRAN proceeds to purchase long-term securities in order to achieve higher investment yields in a manner which could limit liquidity needed to ensure sufficient cash to repay the TRAN when due.

*Minimum legal requirement:* Government Code Section 53821.5 and those sections listed above prohibit the investment of TRAN proceeds in securities that have terms exceeding those of the TRAN itself. In other words, proceeds from a TRAN due June 20 may not be invested in securities that mature after June 20. The minimum legal requirements are clear for securities that have an identifiable term to maturity. However, the law is ambiguous when an agency invests

TRAN proceeds in items that do not have a specific maturity date, such as investments in county pools or other funds that may have an average maturity that is longer than the TRAN.

*Consensus recommendation:* TRAN proceeds can be invested in items that have no specific term to maturity so long as the proceeds can be removed within the period of the TRAN without a penalty. Therefore, liquid funds such as LAIF or county pools – where an agency has relatively quick access to its deposits – are legitimate investments for TRAN proceeds, as long as withdrawals in amounts sufficient to repay the TRAN when due are not restricted or penalized.

## **II. J. What is an appropriate safekeeping arrangement for securities? [Sections 53601 and 53608]**

Many officials have questioned whether state law prohibits the safekeeping of securities in a separate department or subsidiary of the same company from which the securities were bought.

*Minimum legal requirement:* As long as the securities for safekeeping are in the name of or under the control of the agency and kept in a legally separate trust department, they can be held by the same firm from which they were purchased.

*Consensus recommendation:* Industry standard is to set up a third-party (an institution other than the party that sold the agency the investment) safekeeping agreement. The securities may be held by the same institution that sold the security, however, must be kept in a separate area of the company such as its trust department. The security must be in the local agency's name or "perfected" by transferring the security through a signed agreement that contains a description of the security.

## **II. K. Does state law specify the fiduciary relationship that local agencies should have with outside investment management firms? [Section 53600.3]**

*Minimum legal requirement:* A finance officer or treasurer can delegate duties to an external money manager via a principal-agent relationship, but they cannot delegate fiduciary responsibility.<sup>5</sup>

*Consensus recommendation:* Investment managers' fiduciary responsibility is a legal requirement by virtue of their registration with the SEC under the Investment Advisor Act of 1940. Although fiduciary responsibility ultimately rests with the legislative body and the treasurer, and cannot be wholly delegated to an external investment manager, the investment manager (in contrast to a broker/dealer) shares fiduciary responsibilities with the other fiduciaries.

Contracts with external investment managers should allow them to make specific decisions within an established framework. Treasurers should closely monitor the actions of these individuals to ensure they are consistent with the agency's investment policy and philosophy,

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<sup>5</sup> An official legal opinion by the Attorney General for the State of California issued in June 1996 that discusses the relationship between issuers and outside investment managers has been included in the Appendix.

and demand that investment managers provide timely reports that comply with the requirements of state law.<sup>6</sup>

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<sup>6</sup> For more information about using money managers reference the Government Finance Officers Association (GFOA) publication, *An Introduction to External Money Management for Public Cash Management*; and CDIAC's *California Public Fund Investment Primer* publication.

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## CHAPTER III. REPORTING REQUIREMENTS

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Government Code Section 53646 states that all local agencies may file reports on the status of their investment portfolios with their respective legislative body, internal auditor, and chief executive officer. These requirements generally are intended to provide the legislative body the ability to meet its fiduciary obligations as a trustee and to increase the disclosure of the agency's investment activities to those outside the agency. The quarterly investment portfolio report contains, among other things, a listing of investments, fund balances, activity, and return on investments made by the local agency. Quarterly reports should reflect the current positions and past performance of a portfolio of investments for the period of time under consideration.

### III. A. What specific information regarding portfolio investments needs to be included in the report? [Section 53646(b)(1-4)]

*Minimum legal requirements:* If the local agency files a report, it must be submitted within 30 days after the end of the quarter and include the following information:

- Type of investment<sup>7</sup> (i.e., U.S. Treasury security, commercial paper);
- Issuer name;
- Date of maturity;
- Par amount;
- Dollar amount invested in all securities, and investments and monies held by the local agency<sup>8</sup>;
- A description of the funds, investments, and programs (including lending programs) managed by contracted parties (i.e., LAIF, investment pools, outside money managers, and securities lending agents);
- Current market value as of the date of the report of all funds held by the local agency and under the management of any outside party that is not also a local agency or LAIF and the source of the valuation;
- A statement of compliance with the investment policy or an explanation for non-compliance; and

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<sup>7</sup> Refer to CDIAC publication *California Public Fund Investment Primer* for definitions of investment types.

<sup>8</sup> "Dollar amount invested" is defined as cost, however, best practice uses amortized cost or book value. Confusion exists as to the meaning of the words "held by the local agency" found in Government Code Section 53646(b)(1). Several standards have been suggested to clarify this phrase, including "ownership," "control," "under direct management by," "possession," and "accountability for the funds." Each of these suggestions would lead to different determinations as to the specific funds required to be reported. The apparent intent of the Legislature in enacting this requirement was to provide for comprehensive disclosure of local agency investments.

- A statement of the local agency's ability or inability to meet its cash flow needs for the next six months, as well as an explanation of why money will not be available if that is the case.

The legislative body of the local agency may elect to require the report monthly and may receive additional information beyond that listed above.

Government Code Section 53646 includes exceptions to the quarterly reporting requirement including:

- Agencies that deposit all of their funds in the county treasury, the local agency investment fund (LAIF) maintained by the State Treasurer's Office, FDIC insured bank deposits, National Credit Union Shared Insurance Fund-insured accounts in a credit union, accounts insured or guaranteed pursuant to California Financial Code Section 14858, or some combination of the above, may substitute the most recent account statement received from those entities in lieu of the information on these investments that is otherwise required by this section.
- The treasurer or chief fiscal officer are not required to submit a quarterly report to their legislative bodies "for securities, investments, or moneys held by the school district or county office of education in individual accounts that are less than twenty-five thousand dollars (\$25,000)."

*Consensus Recommendation:* Include all of the securities, investments and monies for which the local agency **exercises control** or are **in its possession**. Control implies that the local agency has some discretion to determine how the funds are invested. Possession implies that the local agency has at least a safekeeping role. This standard ensures the broad reporting of local agency investments contemplated by the Legislature. Thus, the report should include the following items:

- agency cash whether invested directly by the agency or by a contract investment manager;
- locally managed pension funds;
- locally managed deferred compensation funds;<sup>9</sup>
- bond funds, because local agencies have the right to direct their investment; and
- endowments and other trust funds.

<sup>9</sup> Most deferred compensation funds are held by third-party administrators and are invested at the direction of program participants. HR 3448, the "Small Business Job Protection Act" (PL 104-188) passed in 1996, states that Section 457 deferred compensation monies are no longer considered assets of the employer if the employer establishes a trust to hold these funds. Once such a trust is established, these third-party administered deferred compensation funds would then be excluded from the investment report. In the case of local agencies that administer their own deferred compensation funds, however, they still would have possession of the funds and should continue to include them in the investment report.

Under this standard, there are few exceptions to inclusion in the report. One exception would be for defeased bond issues, which are typically held and invested by trustees under a contract that precludes agency direction. Agency contributions to the California Public Employees Retirement System (CalPERS) need not be included.

In addition to the elements required by Government Code Section 53646, the investment portfolio report should include:

- Rating of the security;
- Purchase date;
- Fair market value;
- CUSIP, if listing each individual security;
- Rate of return (total return, weighted average yield or both); and
- Comparative performance measures or benchmarks.

With regard to local agencies that have placed *all of their funds* in LAIF, insured accounts, or county investment pools, or any combination of these, the law provides that the most recent account statement received from these institutions may be substituted for the specific investment information generally required. The certification as to the agency's ability to meet its expenditure requirements and the statement of portfolio compliance to investment policy must still be provided.

The law also requires that the report include a description of funds that are under the management of contracted parties, including lending programs. Local agencies should generally describe the investments covered by such contracts, the name of the investment managers, and the nature of the contracts. A portfolio report from the contracting party should provide the securities information recommended in this section and be included as a supplement to the investment report.

### III. B. Should the report include market value measures? [Section 53646(b)(1)]

**1) Should the report include market values for individual securities?** The market value of each security in a portfolio must be computed before determining the portfolio's overall market value.

*Minimum legal requirement:* Government Codes Section 53646(b)(1) states: "With respect to all securities held by the local agency, and under management of any outside party that is not also a local agency or the State of California Local Agency Investment Fund, the report shall also

include a current market value as of the date of the report, and shall include the source of this same valuation."

*Consensus recommendation:* The law is not clear whether "all" securities implies the market value of the overall portfolio or end securities. The level of detail to be presented in the report depends on the portfolio activity and the audience. The report for internal treasury staff and the oversight committee should list the individual market value for each security. This approach gives a more complete picture of the health of a portfolio and brings individual investment performance to the attention of those responsible for compliance oversight. For the legislative body, the report should be a summary with aggregate market value listed and include a footnote stating that data on particular investments is available upon request.

**2) How should the market value of the portfolio be determined?** The Government Code requires reporting the market value of the agency's portfolio. The Government Finance Officers Association (GFOA) recommends that local entities obtain independent third party assessment of investments and risk from a reputable source.

The most common approach is to request pricing information from the agency's safekeeping service, custodial service, or trustee. Agencies may need to contract with pricing service companies for more complex securities. These companies specialize in giving the current market price for a broad range of securities.

An alternative way to determine the value of securities in a portfolio is to perform an in-house analysis by collecting information from different sources such as dealer quotes, on-line computer information, and certain publications that provide price estimates. These sources may not be as up-to-date or accurate as a pricing service, but they offer a relatively inexpensive method to make price estimates. Finally, to assess the worth of securities where specific prices are not available, a treasurer can either tie the spread of a recent investment to a benchmark security that is easy to value or use a matrix pricing formula. A matrix pricing formula displays the prices of a variety of different securities which are then used as a basis for approximating the value of the security in question.<sup>10</sup>

*Minimum legal requirement:* The agency shall include the current market value as of the reporting period date and the source of the valuation.

*Consensus recommendation:* To provide the most unbiased method of reporting current market values, the local agency should obtain an independent valuation of the portfolio from a reputable source, such as, broker or other financial institution, custodial bank, publicly available publications or other pricing services. The independent sources should not be a party to the transaction. For example, the broker that sold the security should not be used to provide the valuation. The agency should use the best sources of market price information available. Prices for securities are estimates that carry a certain degree of error regardless of the approach used and will fluctuate over time due to market conditions. It is imperative that local officials pay extra attention to estimates on complex, infrequently traded, or highly customized securities.

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<sup>10</sup> Matrix pricing formulas are commonly used for short-term securities that mature between 90 and 180 days.

### 3) How frequently should market value be checked?

*Minimum legal requirement:* None, Government Code does not specify frequency of market valuation.

*Consensus recommendation:* Frequency of market valuation will be dependent on the complexity of the securities in the portfolio and the frequency of trading. For infrequent or passive investors, market value should be “marked-to-market” at a minimum quarterly. For a more active portfolio, the industry standard is monthly.

### III. C. Should an analysis of cash flows be prepared by the local agency in order to validate the six-month liquidity certification? [Section 53646(b)(3)]

A component of the report is the statement by the treasurer that the portfolio is liquid enough to meet expected cash flow needs over the next six months. This statement ensures that treasurers are prepared for upcoming obligations by requiring them to consider their projected cash flows. Although the expenditure statement is presumably based on the staff’s knowledge of cash flow requirements, many local agencies do not provide any analysis beyond a brief qualifying statement that says “the treasurer believes the portfolio contains enough cash flow liquidity to meet the next six months of expected expenditures.”

*Minimum legal requirement:* Include a statement saying that the projected cash flow is adequate to meet expected obligations over the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.

*Consensus recommendation:* An analysis of cash flows is not required, however, the treasurer should be prepared to discuss cash flow projections and methodology at the request of legislative and/or oversight bodies. This analysis may list basic projections – based on historical data, market sensitivity or other relevant information – that support the cash flow liquidity statement. There are no guarantees when it comes to predicting future obligations. A sound justification for the expenditure statement gives the finance officer added protection against decisions that originally looked good but turned out poorly because of unforeseen circumstances.

The nature of the analysis will vary greatly depending on the size, sophistication and complexity of the local agency staff and portfolio. Best practices dictate that cash flow statements should be prepared on a regular basis. However, in some agencies it may not be practicable or necessary, for instance, for LAIF-only participants. An analysis of cash flows is the precursor to portfolio management, and should be prepared and updated, as needed, at least for internal investment staff use.

Those who manage investment pools need to pay close attention to the needs and accuracy of the requests of participants to ensure accurate cash flow projections. Incomplete information about a pool’s investors not only compromises the legitimacy of the six-month cash flow statement, but also adds substantially to the liquidity risk of the pool.

In the case of investment pools, all participants’ cash flow needs must be taken into account in preparing the six month cash flow statement. The pool administrator or manager should keep close tabs on mandatory and voluntary pool participants’ cash flows needs and establish clear

criteria for the deposit and withdrawal of their funds. Also, the pool administrator or manager should obtain expected deposit/disbursement information from pool participants at the time of major fund deposits and/or updates of cash flow projections.

### III. D. What tools can be used to measure interest rate risk? [Section 16481.2(b)(2)]

Interest rate risk, also known as market risk, is the risk that a security's value or price will decline as interest rates rise in the general market. Weighted average maturity (WAM) and duration are interest-rate risk measures that are commonly used in the investment industry. WAM measures the portfolio's "average life". Duration provides an approximate percentage change in the value of a security or portfolio for a given change in interest rates.<sup>11</sup> Some local agencies have inquired whether they should include this information in their report.

*Minimum legal requirement:* The Government Code does not specify that local agencies must report an interest rate risk measure in their portfolios. It only requires the State of California to compute the WAM of all investments in its pool.

*Consensus recommendation:* Local agencies should consider requiring the inclusion of the WAM or duration (e.g. modified and/or effective duration) in the report.<sup>12</sup> Duration is the preferred method as it takes into account the present value of the portfolio and considers all of the cash flow receipts not just the last cash flow as in WAM. However, it generally requires the proper software (or access to a source for that information) that can perform the calculation and, thus, its usefulness compared to WAM would be dependent upon the needs and resources of the local agency.

Local agencies also should consider whether their investment policies should provide guidance on acceptable ranges or limits for the respective measure used. These figures trigger a number of valuable questions about the status of the portfolio for both internal and external purposes including liquidity, cash flow, and yield curve position (for example, how far out the portfolio is on the yield curve). An easy method for determining the WAM is to divide the sum of the days to maturity multiplied by the book value for each security by the total book value of the portfolio. Figure 4 shows an example of how WAM is calculated:

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<sup>11</sup> For further information regarding duration, please see CDIAC's publications: *California Public Fund Investment Primer* and *Duration Basics*, which can be found at [www.treasurer.ca.gov](http://www.treasurer.ca.gov).

<sup>12</sup> Modified duration measures the percentage change in a security's price for each percentage change in interest rates. Effective duration further refines modified duration using an iterative estimation process and is typically used when securities have a call option feature.

**Figure 4:**  
**Calculation of Weighted Average Maturity**

Par Value	Security Description	Days to Maturity	Book Value	Days Multiplied by Book Value
\$1,350,000	Repurchase Agreements	1	\$1,350,000	1,350,000
\$5,000,000	Local Agency Inv. Fund	1	\$5,000,000	5,000,000
\$5,000,000	Fed Natl. Mtg. Assn.	185	\$4,886,108	903,930,041
\$5,000,000	Fed Home Loan Bank	550	\$5,000,000	2,750,000,000
\$5,000,000	U.S. Treasury Note	720	\$4,985,156	3,589,312,500
\$5,000,000	Fed Natl. Mtg. Assn.	822	\$5,000,000	4,110,000,000
\$5,000,000	Fed Farm Credit Bank	910	<u>\$4,988,941</u>	<u>4,539,936,255</u>
	<b>Total</b>		<b>\$31,210,206</b>	<b>15,899,528,796</b>

**WAM = [Summation (Days to Maturity Multiplied by Book Value of Each Investment)] / Total Book Value**  
**= 15,899,528,796 / 31,210,206**  
**= 509 Days or 1.42 Years WAM**

Duration is a more complex computation and requires the proper software to perform the specific calculations for each security and then for the entire portfolio. The following matrix is an example of a basic modified duration application:

**Figure 5:**  
**Duration – Gain/Loss of Market Value Matrix**  
For a \$100,000,000 Portfolio

Rate Change	Portfolio Modified Duration			
(%)	1.2	2.7	5.0	6.0
.25	\$ 300,000	\$ 675,000	\$1,250,000	\$1,500,000
.50	\$ 600,000	\$1,350,000	\$2,500,000	\$3,000,000
1.50	<b>\$1,800,000</b>	<b>\$4,050,000</b>	\$7,500,000	\$9,000,000
2.00	<b>\$2,400,000</b>	<b>\$5,400,000</b>	\$10,000,000	\$12,000,000
5.00	\$6,000,000	\$13,500,000	\$25,000,000	\$30,000,000

As already noted, modified duration measures how for every 1 percent change in market interest rates, the market value of a bond will change **inversely** by a certain percentage depending on its duration. Thus, for a portfolio with a market value of \$100,000,000 and a duration of 1.2, as interest rates increase by 1.5 percent, the portfolio's market value would be expected to decrease by \$1,800,000. Specifically:

$\$100,000,000$  (portfolio size) \*  $1.2$  (duration) \*  $.015$  (change in interest rate) =  $\$1,800,000$  (decrease in portfolio market value)

Conversely, for the same portfolio, if interest rates were to decrease by say 2 percent, the portfolio's market value increases by \$2,400,000. Specifically:

$\$100,000,000 * 1.2 * .02 = \$2,400,000$  (increase in portfolio market value)

Securities or portfolios with higher duration carry more interest rate risk and have higher price volatility (i.e., sensitivity of the security's price to changes in its yield) than those with lower durations. For example, for the same portfolio with a duration of 2.7, and when interest rates increase by 1.5 percent, the change in the portfolio's market value is more significant:

$\$100,000,000 * 2.7 * .015 = \$4,050,000$  (decrease in market value)

For a 2 percent decrease in interest rates:

$\$100,000,000 * 2.7 * .02 = \$5,400,000$  (increase in market value)

### III. E. What action should the legislative body take with the report? [Section 53646(b)]

The Government Code states that the "treasurer or chief fiscal officer may render a quarterly report to the chief executive officer, internal auditor, and the legislative body" within 30 days of the quarter's end. Questions have arisen as to whether the legislative body needs to discuss and approve the report during a regular meeting, have it placed on the consent calendar, or only receive a copy.

*Minimum legal requirement:* The Government Code only states that the report may be rendered to the legislative body. It does not require the legislative body to take action on this report.

*Consensus recommendation:* If presented to the legislative body of the local agency, it should discuss the report as necessary, and take action on the report in public session. The report could be listed as a consent calendar item or as a non-consent calendar item, depending on the preferences of the legislative body. Possible actions of the governing body on the report could include: receiving and filing the report, approving or disapproving the report (with or without amendments), and/or asking staff for further information/clarification. In addition, if presented to investment oversight bodies, they should discuss the reports at their own meetings.

### III. F. How should agencies address difficulties in meeting the 30-day requirement? [Section 53646(b)]

It can be difficult for an agency to collect all the appropriate information for the report, have an oversight committee (if a jurisdiction has one) review and/or approve it, and present it to the legislative body within 30 days of the quarter's end. Various factors such as the length and

diversity of the portfolio, size of staff, and computer software can influence the amount of time it takes to compile a report.

*Minimum legal requirement:* The law requires that if the quarterly investment report is submitted to the legislative body, it may be rendered within 30 days of the end of the quarter.

*Consensus recommendation:* A report, as complete as possible, should be submitted within the allotted 30 days. If current values for certain investments are not available within the time frame to complete the report in a timely fashion, submit the report on time and indicate in the report the most recent valuation and its date and then submit updated values to the legislative body at the soonest date possible thereafter. It should be available for individual legislative body members to review within 30 days of quarter end. This may include providing a copy to each member, including it in agenda materials for a public meeting, or actually presenting the report at a public meeting of the legislative body.



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## CHAPTER IV. TREASURY OVERSIGHT COMMITTEES

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The function of the treasury oversight committee is to monitor and review the county investment policy by conducting or causing an annual audit and discussing their findings at a public meeting. The rationale behind the creation of an oversight committee is to give local agencies and private sector citizens a say in the policies governing the investment pool.

### IV. A. What options are available for structuring the county treasury oversight committee? [Sections 27131 and 27132.1 through 27132.4]

Counties often find it difficult to attract private sector citizens to serve on oversight committees due to restrictions on membership. For example, the law prevents members from securing employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms with whom the treasurer is doing business during service on the committee or within one year after leaving the committee. Presumably this would allow those currently employed in the private sector to remain so, but would prevent any other committee member from securing employment in these fields. Read literally, this prevents committee members currently employed in these private sector fields from changing jobs for one year after leaving the committee.

Another restriction prohibits any committee member from making individual political contributions to, or being employed by an entity that makes political contributions to, or from doing any fund raising on behalf of, any candidate for office of the governing board of any agency that deposits funds in the county treasury in the previous three years. The legislation specifies that members of the committee can include six local elected officials. Many elected officials are politically active and participate financially in the campaigns of other local candidates and a literal reading could deny them the opportunity for committee membership.

*Minimum requirement:* Government Code Section 27131(a) states that the board of supervisors in any county that invests surplus money may establish a treasury oversight committee. If established, the committee must consist of three to eleven members appointed from the following categories:

1. County treasurer.
2. County auditor, controller, or finance director as the case may be.
3. A representative appointed by the board of supervisors.
4. A representative selected by a majority of the school districts and community college districts.
5. County superintendent of schools or his/her designee.
6. A representative of special districts that are required or authorized to deposit funds in the county treasury.

7. Up to five other members of the public.

A majority of the public members of the committee shall have expertise in, or an academic background in, public finance. The other public members shall be economically diverse and bipartisan in political registration. Committee members cannot:

- Be employed by an entity that has contributed to the campaign of a candidate for the office of local treasurer;
- Be employed by an entity which contributed to the campaign of a candidate to be a member of a legislative body of any local agency that has deposited funds in the county treasury in the previous three years;
- Directly or indirectly raise funds for a candidate for local treasurer or a member of the governing board of any local agency that has deposited funds in the county treasury; and
- Secure employment with bond underwriters, bond counsel, security brokerages or dealers, or with financial services firms with whom the treasurer is doing business during the period that the person is a member of the committee or for one year after leaving the committee.

**Figure 6:  
Approaches to Establishing the County  
Treasury Oversight Committee**

**Various Options Available to Local Governments**

1. A committee of both public and private sector members.
2. A committee of public sector officials that has an advisory board made-up of private sector professionals and citizens.
3. A committee that only consists of individuals who work for agencies that have funds invested in pool.

*Consensus recommendation:* Counties' legislative bodies should decide if an oversight committee is necessary and if they should continue to have private sector individuals serve on the committee. If so, then the county must either attract citizens who are willing to avoid seeking employment in the public finance industry or, if they are currently employed in that capacity, not to change jobs for one year after leaving the committee (see Figure 6, approach #1 above). A county can also solicit input from those who work in the private sector of public finance by establishing an advisory board to the county treasury oversight committee that has restrictions that are less stringent than those of the county oversight committee (see Figure 6, approach #2 above). If a county does not believe private sector input is important, they can limit membership

on the oversight committee to those who work in the public sector (see Figure 6, approach #3 above).

#### **IV. B. Does the appointment of the treasurer to the county treasury oversight committee create a conflict of interest? [Sections 27131 and 27132]**

Since the oversight committee's central task is to oversee the treasurer's policies, some believe that allowing the treasurer to sit on the oversight committee represents a conflict of interest. Others claim that a treasurer who donates money to his/her own campaign cannot be on the county treasury oversight committee because the law forbids membership to those who contribute to the campaign of someone running for treasurer while serving on the committee.

*Minimum legal requirement:* None. Government Code Sections 27131 and 27132 do not specify whether or not the county treasurer should be a member of the oversight committee. Section 27132 specifically lists the county treasurer as a potential member of the county treasury oversight committee.

*Consensus recommendation:* The question of whether or not a county treasurer should sit on the treasury oversight committee must be made by the county board of supervisors and the treasurer. Their answer should consider the advantages and disadvantages of having someone with the treasurer's influence and expertise sit on the committee and the future employment implications to the treasurer (since any person who serves on a county treasury oversight committee is prohibited from seeking employment with the financial services industry for one year after leaving the committee). It should not in any way hinge on whether or not a treasurer donated money to his/her own campaign.

Contributing money to one's own campaign, or contributions from one elected official to another elected official, does not represent a legitimate conflict of interest in the context of the treasury oversight committee.

Specifying that the treasurer does not serve as the chair of the oversight committee is one approach to lessening the "conflict of interest" concern.

#### **IV. C. What is the role of the county treasury oversight committee? [Sections 27134 and 27137]**

*Minimum legal requirement:* Government Code Sections 27134 and 27137 limit the oversight committee's functions to monitoring and reviewing the county treasury's compliance with the investment policy and reporting provisions of the Government Code through an annual audit.

*Consensus recommendation:* The Government Code provisions address concerns that individuals serving on the treasury oversight committees may try to micro-manage decisions that should be left to the treasurer. Considerations by the committee regarding the risk and structure of a portfolio are permitted in the law; however, any attempts to direct individual investment decisions, select individual investment advisors, brokers, or dealers, or impinge on the day-to-day operations of the county treasurer are discouraged. The local agency should clearly stipulate that the responsibilities of the treasury oversight committee are to focus on investment policy

issues and to audit the portfolio for compliance with the policy. The oversight committee should not impinge on the day-to-day operations of the county treasurer.

#### IV. D. Should other local agencies have treasury oversight committees?

It is not uncommon to find treasury oversight committees in cities and other local agencies even though the law does not require them to have such a committee. An important issue in the decision to establish a committee is the level of discretion accorded the agency treasurer in making investment decisions. The more discretion, the greater the need for oversight procedures. However, even in situations where an agency has a great deal of discretion, some believe an oversight committee merely duplicates work that can be better performed by the governing board and/or auditors. Others support the view that an oversight committee provides valuable information to the investment staff and involves members of the community in an important government function. If other local agencies decide that they want to engage an oversight committee, its role with respect to reviewing investment policies and quarterly investment reports should be clearly specified.

*Minimum legal requirement:* There are no legal requirements for local agencies to have oversight committees.

*Consensus recommendation:* Each non-county local agency should consider for itself if an oversight committee is appropriate based on its current oversight procedures, complexity of its portfolio, frequency with which it purchases securities, and skill level of its staff. The limitations and restrictions associated with county treasury oversight committee members do not apply to committees formed by other local government entities.

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## GLOSSARY

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**Accrued Interest** – Coupon interest accumulated on a bond or note since the last interest payment or, for a new issue, from the dated date to the date of delivery.

**Arbitrage** – Transactions by which securities are bought and sold in different markets at the same time for the sake of the profit arising from a yield difference in the two markets. The 1986 Tax Reform Act made this practice by municipalities illegal solely as a borrowing tactic, except under certain safe-harbor conditions.

**Asset-backed Securities** – Securities that are supported by pools of assets, such as installment loans or leases, or by pools of revolving lines of credits. Asset-backed securities are structured as trusts in order to perfect a security interest in the underlying assets.

**Average**– An arithmetic mean of selected stocks intended to represent the behavior of the market or some component of it.

**Bank Notes** – A senior, unsecured, direct obligation of a bank or U. S. branch of a foreign bank.

**Bankers' Acceptance** – A draft or bill or exchange accepted by a bank or trust company. The accepting institution, as well as the issuer, guarantees payment of the bill.

**Bank Deposits** – To deposit collateral in the form of currency that may be in the form of demand accounts (checking) or investments in accounts that have a fixed term and negotiated rate of interest.

**Basis Points** – Refers to the yield on bonds. Each percentage point of yield in bonds equals 100 basis points (1/100% or 0.01%). If a bond yield changes from 7.25% to 7.39%, that is a rate of 14 basis points.

**Benchmark** – A passive index used to compare the performance, relative to risk and return, of an investor's portfolio.

**Bond Proceeds** – The money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities. These moneys are used to finance the project or purpose for which the securities were issued and to pay certain costs of issuance as may be provided in the bond contract.

**Bonds** – A debt obligation of a firm or public entity. A bond represents the agreement to repay the debt in principal and, typically, in interest on the principal.

**Book Value** - The value at which an asset is carried on a balance sheet.

**Broker** – A person or firm that acts as an intermediary by purchasing and selling securities for others rather than for its own account.

**Callable Securities** – An investment security that contains an option allowing the issuer to retire the security prior to its final maturity date.

**Cash Flow** – A comparison of cash receipts (revenues) to required payments (debt service, operating expenses, etc.).

**Certificates of Deposit** – A short-term, secured deposit in a financial institution that usually returns principal and interest to the lender at the end of the loan period. Certificates of Deposit (CDs) differ in terms of collateralization and marketability. Those appropriate to public agency investing include:

Negotiable Certificates of Deposit – Generally, short-term debt instrument that usually pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. The majority of negotiable CDs mature within six months while the average maturity is two weeks. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

Non-Negotiable Certificates of Deposit – CDs that carry a penalty if redeemed prior to maturity. A secondary market does exist for these non-negotiable CDs, but include a transaction cost that reduces returns to the investor. Non-negotiable CDs issued by banks and savings and loans are insured by the Federal Deposit Insurance Corporation up to the amount of \$100,000, including principal and interest. Amounts deposited above this amount may be secured with other forms of collateral through an agreement between the investor and the issuer. Collateral may include other securities including Treasuries or agency securities such as those issued by the Federal National Mortgage Association.

**CDARS (Certificate of Deposit Account Registry System)** – A private CD placement service that allows local agencies to purchase more than \$100,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the California institution and other participating institutions in amounts that are less than \$100,000 each, so that FDIC coverage is maintained.

**CD Placement Service** – A service that allows local agencies to purchase more than \$100,000 in CDs from a single financial institution while still maintaining FDIC insurance coverage. See “CDARS”

**Collateralization** – Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

**Commercial Paper** – An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 270 days.

**Corporate Notes and Bonds** – Debt instruments, typically unsecured, issued by corporations, with original maturities in most cases greater than one year and less than ten years.

**County Pooled Investment Funds** – The aggregate of all funds from public agencies placed in the custody of the county treasurer or chief finance officer for investment and reinvestment.

**Coupon** – The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value; a certificate attached to a bond evidencing interest due on a payment date.

**Credit Rating** – Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness. Standard & Poor's and Fitch Ratings use the same system, starting with their highest rating, of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D for default. Moody's Investors Service uses Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, and D. Each of the services use pluses (+), minuses (-), or numerical modifiers to indicate steps within each category. The top four letter categories are considered investment grade ratings.

**Credit Risk** – The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market's perception of a corporation's credit will cause the market value of a security to fall, even if default is not expected.

**CUSIP Number** – The Committee on Uniform Security Information Procedures (CUSIP) Number refers to a security's identification number assigned to each publicly traded security by the CUSIP Service Bureau operated by Standard & Poor's for the American Bankers Association. The CUSIP Number is a nine-character identifier unique to the issuer, the specific issue and the maturity, if applicable (the first six characters identifying the issuer, the next two identifying the security and the last digit providing a check digit to validate the accuracy of the preceding CUSIP number).

**Custodian** – A bank or other financial institution that keeps custody of stock certificates and other assets.

**Dealer** – Someone who acts as a principal in all transactions, including underwriting, buying, and selling securities, including from his/her own account.

**Defeased Bond Issues** – Issues that have sufficient money to retire outstanding debt when due so that the agency is released from the contracts and covenants in the bond document.

**Derivative** – Securities that are based on, or derived from, some underlying asset, reference date, or index.

**Discount** – Discount means the difference between the par value of a security and the cost of the security, when the cost is below par. Investors purchase securities at a discount when return to the investor (yield) is higher than the stated coupon (interest rate) on the investment.

**Duration** – A measure of the timing of the cash flows to be received from a security that provides the foundation for a measure of the interest rate sensitivity of a bond. Duration is an elasticity measure and represents the percentage change in price divided by the percentage

change in interest rates. A high duration measure indicates that for a given level of movement in interest rates, prices of securities will vary considerably.

**Effective Duration** – Duration measures the weighted average of the present value of the cash flows of a fixed-income investment. Effective duration measures the price sensitivity of fixed-income investments, especially for those with embedded option features such as call options. As yields rise, the effective duration of a callable investment rises to reflect the fact that it has become less likely to be called. The more rates rise, the longer the effective duration will become, approaching the duration to maturity. The converse is true in a declining interest rate environment (that is, the more rates fall, the shorter the effective duration will become, approaching the duration to call). For securities without an embedded option, the duration to call, maturity, and effective duration are all the same. The calculation for effective duration is complicated and involves averaging the duration under a simulation of many possible interest rate scenarios in the future.

**Extendable Notes** – Securities with maturity dates that can be extended by mutual agreement between the issuer and investor. When investing in these types of securities, the maturity date plus the stated extendable option must not exceed the time frames that are allowed in California Government Code or the investment policy for the investment type.

**Fiduciary** – An individual who holds something in trust for another and bears liability for its safekeeping.

**First Tier Securities** – Securities that have received short-term debt ratings in the highest category from the requisite nationally recognized statistical-rating organizations (NRSROs), or are comparable unrated securities, or are issued by money market funds, or government securities. [See SEC Rules: Paragraph (a)(12) of rule 2a-7.]

**Government Accounting Standards Board (GASB)** – A standard-setting body, associated with the Financial Accounting Foundation, which prescribes standard accounting practices for governmental units.

**Guaranteed Investment Contracts (GICs)** – An agreement acknowledging receipt of funds for deposit, specifying terms for withdrawal, and guaranteeing a rate of interest to be paid.

**Interest** – The amount a borrower pays to a lender for the use of his or her money.

**Investment Agreements** – Investment agreements are contracts with respect to funds deposited by an investor. Investment agreements are often separated into those offered by banks and those offered by insurance companies. In the former case, they are sometimes referred to as “bank investment contracts.”

**Investment Oversight Committee** – A committee of three to eleven members formed under Government Code Section 27131 to monitor and review a county’s investment policy by causing an annual audit and discussing its finding at an open meeting. Although cities and other local agencies are not required to compose an investment oversight committee, the State Legislature

has declared that all local agencies “should participate in reviewing the policies that guide the investment of those funds.”

**Liquidity** – The measure of the ability to convert an instrument to cash on a given date at full face or par value.

**Liquidity Risk** – The chance that a security, sold prior to maturity, will be sold at a loss of value. For a local agency, the liquidity risk of an individual investment may not be as critical as how the overall liquidity of the portfolio allows the agency to meet its cash needs.

**Local Agency Investment Fund** – A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer’s Office.

**Local Government Investment Pool (LGIP)** – Investment pools that range from the State Treasurer’s Office Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

**Market Risk** – The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall. Market risk also is referred to as systematic risk or risk that affects all securities within an asset class similarly.

**Market Value** – The price at which a security is trading and presumably could be purchased or sold at a particular point in time.

**Maturity** – The date on which the principal or stated value of an investment becomes due and payable.

**Medium-Term Note** – Corporate or depository institution debt securities meeting certain minimum quality standards (as specified in the California Government Code) with a remaining maturity of five years or less.

**Money Market Mutual Funds** – MMF’s are mutual funds that invest exclusively in short-term money market instruments. MMF’s seek the preservation of Capital as a primary goal while maintaining a high degree of liquidity and providing income representative of the market for short term investments.

**Mortgage Backed Securities** – Mortgage-backed securities (MBS) are created when a mortgagee or a purchaser of residential real estate mortgages creates a pool of mortgages and markets undivided interests or participations in the pool. MBS owners receive a prorata share of the interest and principal cash flows (net of fees) that are “passed through” from the pool of mortgages. MBS are complex securities whose cash flow is determined by the characteristics of the mortgages that are pooled together. Investors in MBS face prepayment risk associated with the option of the underlying mortgagors to pre-pay or payoff their mortgage. Most MBS are issued and/or guaranteed by federal agencies and instrumentalities (e.g., Government National

Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), and Federal Home Loan Mortgage Corporation (FHLMC)).

**Mortgage Pass-through Obligations** – Securities that are created when residential mortgages (or other mortgages) are pooled together and undivided interests or participations in the stream of revenues associated with the mortgages are sold.

**Municipal Notes, Bonds, and other Obligations** – Obligations issued by state and local governments to finance capital and operating expenses.

**Mutual Funds** – An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments.

**Net Asset Value** – Net asset value (NAV) is a term used in the mutual fund industry to determine the average price per share of a pool or mutual fund. How this measure varies over time provides information on whether the pool is stable or variable. NAV is the market value of all securities in a mutual fund, less the value of the fund's liabilities, divided by the number of shares in the fund outstanding. Shares of mutual funds are purchased at the fund's offered NAV.

**Net Present Value** – An amount that equates future cash flows with their value in present terms.

**Note** – A written promise to pay a specified amount to a certain entity on demand or on a specified date. Usually bearing a short-term maturity of a year or less (though longer maturities are issued – see “Medium-Term Note”).

**Options** – An option is a contract that gives the buyer the right to buy or sell an obligation at a specified price for a specified time. Exchange Traded Options are standardized option contracts that are actively traded on the Chicago Board of Exchange on a daily basis whereas Over-the-Counter Options are traded directly between the buyer and seller at agreed upon prices and conditions (the former type of option is therefore more liquid than the latter).

**Par Amount or Par Value** – The principal amount of a note or bond which must be paid at maturity. Par, also referred to as the “face amount” of a security, is the principal value stated on the face of the security. A par bond is one sold at a price of 100 percent of its principal amount.

**Portfolio** – Combined holding of more than one stock, bond, commodity, real estate investment, cash equivalent, or other asset. The purpose of a portfolio is to reduce risk by diversification.

**Premium** - Premium means the difference between the par value of a security and the cost of the security, when the cost is above par. Investors pay a premium to purchase a security when the return to the investor (yield) is lower than the stated coupon (interest rate) on the investment.

**Price** – Price is the amount of monetary consideration required by a willing seller and a willing buyer to sell an investment on a particular date.

**Principal** – The face value or par value of a debt instrument, or the amount of capital invested in a given security.

**Prospectus** – A legal document that must be provided to any prospective purchaser of a new securities offering registered with the SEC that typically includes information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements (also known as an "official statement").

**Prudent Investor Standard** – A standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. The test of whether the standard is being met is if a prudent person acting in such a situation would engage in similar conduct to ensure that investments safeguard principal and maintain liquidity.

**Repurchase Agreements** – An agreement of one party (for example, a financial institution) to sell securities to a second party (such as a local agency) and simultaneous agreement by the first party to repurchase the securities at a specified price from the second party on demand or at a specified date.

**Reverse Repurchase Agreements** – An agreement of one party (for example, a financial institution) to purchase securities at a specified price from a second party (such as a public agency) and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

**Risk** – The uncertainty of maintaining the principal or interest associated with an investment due to a variety of factors.

**Rule G-37 of the Municipal Securities Rulemaking Board** – Federal regulations to sever any connection between the making of political contributions and the awarding of municipal securities business.

**Safekeeping Service** – Offers storage and protection of assets provided by an institution serving as an agent.

**Safety** – In the context of investing public funds, safety relates to preserving the principal of an investment in an investment portfolio; local agencies address the concerns of safety by controlling exposure to risks.

**Securities and Exchange Commission (SEC)** – The federal agency responsible for supervising and regulating the securities industry.

**Securities Lending Agreement** – An agreement of one party (for example, a local agency) to borrow securities at a specified price from a second party (for example, another local agency) with a simultaneous agreement by the first party to return the security at a specified price to the second party on demand or at a specified date. These agreements generally are collateralized and involve a third-party custodian to hold the securities and collateral. Economically similar to reverse repurchase agreement.

**State Notes, Bonds, and Warrants** – Obligations of the State of California or another state government with different maturity lengths.

**Swap** - A swap is any financial transaction that involves the simultaneous purchase of a security and the sale of another for the purpose of enhancing an investor's portfolio. Swap transactions of interest to California public investors include portfolio swaps and interest rate swaps.

**Tax and Revenue Anticipation Notes (TRANS)** – Notes issued in anticipation of receiving tax proceeds or other revenues at a future date.

**Time Deposits** – Time deposits are issued by depository institutions against funds deposited for a specified length of time. Time deposits include instruments such as deposit notes. They are distinct from certificates of deposit (CDs) in that interest payments on time deposits are calculated in a manner similar to that of corporate bonds whereas interest payments on CDs are calculated similar to that of money market instruments.

**Trustee, trust company or trust department of a bank** – A financial institution with powers to act in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

**Underwriter** – A dealer that purchases a new issue of municipal securities for resale.

**U.S. Treasury Obligations** – Debt obligations of the U.S. Government sold by the Treasury Department in the forms of bills, notes, and bonds. Bills are short-term obligations that mature in one year or less and are sold at a discount. Notes are obligations that mature between one year and ten years. Bonds are long-term obligations that generally mature in ten years or more.

**Weighted Average Maturity (WAM)** – The average maturity of all the securities that comprise a portfolio, typically expressed in days or years.

**Yield** – The current rate of return on an investment security generally expressed as a percentage of the securities current price.

**Yield Curve** – A graphic representation that shows the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity.

**Zero-Interest Bond** – A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. Zero-interest bonds are typically issued at a discount and repaid at par upon maturity.

**APPENDIX A**

**MODEL INVESTMENT POLICY**  
**THE ASSOCIATION OF PUBLIC TREASURERS OF**  
**THE UNITED STATES AND CANADA**

**APT US&C**  
**Investment Policy Certification Program**

Dear Applicant:

Thank you for your interest in APT US&C's Investment Policy Certification Program.

The Investment Policy Certification Program provides professional guidance and assistance in developing or improving existing investment policies in the public sector. Entities may request the Investment Policy Certification Committee to review their policy to determine if they have met the standards set forth by the Association. Those jurisdictions that comply with APT US&C's criteria are presented with the Association's Written Investment Policy Certification.

Enclosed please find the necessary documents to apply for APT US&C's Written Investment Policy Certification – Application Form and APT US&C Model Investment Policy. The application form along with specified documentation must be completed and forwarded directly to APT US&C. The information solicited will assist the assigned reviewers in analyzing your investment policy.

### Program Procedures

1. Submit five copies of the application form and appropriate documentation to APT US&C. The program fee is \$175 for APT US&C members (\$275 for non-members). If the first submission is unsuccessful, the application fee will be waived for a second submission. Resubmissions must be made by June 1st of the following year.
2. The submitted investment policy documentation will be forwarded to three reviewers who will evaluate the investment policy and make a recommendation as to certification. Two out of three members must vote in favor of awarding certification in order for the entity to receive APT US&C's Written Investment Policy Certification. To assist the reviewers, please enclose five copies of your investment policy, including your glossary.
3. Approximately six weeks after receipt of submission, notification of certification will be mailed to the individual identified on the application form (Item 15) as well as the treasurer requesting the review. Comments from the reviewers will be forwarded to both successful and unsuccessful applicants.
4. Investment Policy review and certification occur continually throughout the year. However, investment policies must be submitted by June 1st in order for successful applicants and entities to receive recognition and a plaque at APT US&C's annual conference in August.

Should you have any questions about the application or the model investment policy, please contact Ernie O'Dell, Investment Policy Certification Chair at (310) 372-1171 x2752. We appreciate your comments or suggestions relating to this certification program.

Kelley Noone  
Executive Director

## Application Form for a Written Investment Policy Certification

Please return this application form along with the program fee of \$175 (\$275 for non-members) to APT US&C, Investment Policy Certification Program, 962 Wayne Avenue, Suite 910, Silver Spring, MD 20910. Enclose five copies of the application form and five copies of your investment policy.

1. Name of government: (as it will appear on your plaque)

\_\_\_\_\_

Mailing Address:

\_\_\_\_\_

2. Population of government/size of district/retirement system:

\_\_\_\_\_

3. Size of total investment portfolio: \_\_\_\_\_

4. Indicate below the composition of the current portfolio:

Treasuries	\$ _____	CD's	\$ _____
Agencies	\$ _____	BA's	\$ _____
Govt. Pool	\$ _____	Repos	\$ _____
Mutual Funds	\$ _____	Other	\$ _____

5. What is the average maturity of your investment portfolio? \_\_\_\_\_ days

6. Are you a member of APT US&C? yes \_\_\_\_\_ no \_\_\_\_\_

7. Has your investment policy been adopted by the appropriate legislative body?

yes \_\_\_\_\_ no \_\_\_\_\_

*(Not required prior to submission)*

8. Does your state/province or jurisdiction specifically mandate the adoption of an investment policy?

State/Province yes \_\_\_\_\_ no \_\_\_\_\_

Jurisdiction yes \_\_\_\_\_ no \_\_\_\_\_

9. Does your state/province specifically outline types of authorized investments?

yes \_\_\_\_\_ no \_\_\_\_\_

*(If yes, attach five copies of the legislation or a typed summary of types of authorized investments).*

10. Does your entity have a separate investment procedure manual? yes \_\_\_\_\_ no \_\_\_\_\_

*(It is not required that you send your procedure manual.)*

11. List investment staff by title and telephone number:

_____	_____
_____	_____
_____	_____

12. If the policy permits investment in repurchase agreements, does your entity have a signed Master Repurchase Agreement? yes \_\_\_\_\_ no \_\_\_\_\_ n/a \_\_\_\_\_  
If "Yes" – A Master Repurchase Agreement is required for certification.

13. Do you employ an active or passive approach to investing?  
Active \_\_\_\_\_ Passive \_\_\_\_\_

14. Treasurer requesting review:

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Address: \_\_\_\_\_

Phone number: \_\_\_\_\_

15. In addition to the Treasurer requesting review (item 14), who should the formal announcement of the awarding of the Written Investment Policy Certification be addressed to?

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Address: \_\_\_\_\_

16. Have you enclosed five copies of the following documents?

- Application Form
- Investment Policy
- Glossary
- State/Province Statutes Listing Authorized Investments

17. Date submitted \_\_\_\_\_

The APT US&C Model Investment Policy is intended to provide guidance in the formulation of a structure to govern the investment of public funds. It must be implemented in conjunction with a careful reading of and strict adherence to applicable statutes, judicial decisions and legal opinions. It is not a guarantee against loss due to economic and market conditions or human behavior. APT US&C strongly recommends updating your policy at least every five (5) years.

APT use only:

Date Received	_____	Reviewers	_____
Check#	_____		_____
Amount	_____		_____
Date Sent for Review	_____	Result/Date	_____

# ASSOCIATION OF PUBLIC TREASURERS OF THE UNITED STATES AND CANADA

## Model Investment Policy

For permission to reprint the Model Investment Policy, call the APT US&C at (301) 495-5560.

### **1.0 Policy:** *(maximum points: 4)*

#### **SAMPLE LANGUAGE:**

It is the policy of the (entity) to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the entity and conforming to all state/province and local statutes governing the investment of public funds.

### **2.0 Scope:** *(maximum points: 7)*

#### *Rationale:*

*\*An investment policy should explain its scope Does the policy apply to all funds held in the custody of the government jurisdiction and all of its offices?*

#### **SAMPLE LANGUAGE:**

This investment policy applies to all financial assets of the (entity). These funds are accounted for in the (entity's) Comprehensive Annual Financial Report and include:

#### 2.1 Funds: *(Specifically designate. Following is a sample list.)*

##### 2.1.1 General Fund

##### 2.1.2 Special Revenue Funds

##### 2.1.3 Capital Project Funds

##### 2.1.4 Enterprise Funds

##### 2.1.5 Trust and Agency Funds

##### 2.1.6 Retirement/Pension Funds

##### 2.1.7 *(Any new fund created by the legislative body, unless specifically exempted.)*

### **3.0 Prudence:** *(maximum points: 4)*

#### *Rationale:*

*\*To burden a conscientious professional with personal responsibility for a default on a single item within a diversified portfolio seems unduly severe. (Accordingly, public entities with portfolios of sufficient size are urged to apply the prudence concept to the overall portfolio.) Following is the prudent person standard:*

## **SAMPLE LANGUAGE:**

Investments shall be made with judgment and care – under circumstances then prevailing – which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

3.1 The standard of **prudence** to be used by investment officials shall be the "prudent person" and/or "prudent investor" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

## **4.0 Objective:** (*maximum points: 10*)

### *Rationale:*

*\*Every investment policy should contain a concise and clear statement(s) of objectives. The effectiveness of the investment program is set by the caliber of the staff, the procedures used, the working environment and the policy guidance provided by governing officials. Through its statement of objectives, the governing body sets the tone and direction of the policy and investment program.*

## **SAMPLE LANGUAGE:**

The primary objectives, in priority order, of the *entity's*) investment activities shall be:

4.1 **Safety:** Safety of principal is the foremost objective of the investment program. Investments of the (*entity*) shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, the (*entity*) will diversify its investments by investing funds among a variety of securities offering independent returns and financial institutions.

4.2 **Liquidity:** The (*entity's*) investment portfolio will remain sufficiently liquid to enable the (*entity*) to meet all operating requirements which might be reasonably anticipated.

4.3 **Return on Investments:** The (*entity's*) investment portfolio shall be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles, commensurate with the (*entity's*) investment risk constraints and the cash flow characteristics of the portfolio.

## **5.0 Delegation of Authority:**

**Delegation of Authority:** *(maximum points: 4)*

*Rationale:*

*\*After the investment objectives have been identified, the next logical element of an investment policy is an explicit delegation of authority to investment officials responsible for conducting transactions and managing the entity's investment program.*

### **SAMPLE LANGUAGE:**

Authority to manage the *(entity's)* investment program is derived from the following: *(e.g., trading resolutions, code citations, ordinances, statutes, etc.)*. Management responsibility for the investment program is hereby delegated to the *(designated official)* who shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials, and their procedures in the absence of the *(Designated Official)*.

### **5.1 Investment Procedures:** *(maximum points: 4)*

The *(designated official)* shall establish written investment policy procedures for the operation of the investment program consistent with this policy. The procedures should include reference to: safekeeping, PSA repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the *(designated official)*. *See appendix to APT US&C's Model Investment Policy entitled APT US&C's Guidelines for an Investment Procedures Manual.*

## **6.0 Ethics and Conflicts of Interest:** *(maximum points: 4)*

*Rationale:*

*\*Some governments have adopted conflict-of interest legislation that regulates the activities of certain officers and employees. In the investment area, general code provisions, so separate policies may be redundant, may govern certain conflicts. Some jurisdictions, however, may seek to adopt policies regarding ethical behavior and conflicts of interest.*

### **SAMPLE LANGUAGE:**

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the *(Chief Executive Officer)* any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the *(entity)*.

## **7.0 Authorized Financial Dealers and Institutions:** (maximum points: 7)

### *Rationale:*

*\*The investment policy should require that a set formal process be used to select depositories and brokers/dealers in money market instruments. Because the policy is intended to endure, it should not mention specific firms or depositories. Rather it should provide for a process that will screen out institutions that lack economic viability or whose past practices suggest that the safety of public capital would be impaired if transactions were directed to or through such firms.*

### **SAMPLE LANGUAGE:**

The Treasurer will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained for approved or security broker/dealers selected by credit worthiness that are authorized to provide investment services in the State/Province of (\_\_\_\_\_). These may include "primary" dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state/province laws. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the treasurer with the following: (e.g. *audited financial statements, proof of National Association of Security Dealers certification, trading resolution, proof of state/province registration, completed broker/dealer questionnaire, certification of having read entity's investment policy and depository contracts.*)

An annual review of the financial condition and registrations of qualified bidders will be conducted by the Treasurer. A current audited financial statement is required to be on file for each financial institution and broker/dealer in which the (entity) invests.

## **8.0 Authorized & Suitable Investments:** (maximum points: 10)

### *Rationale:*

*\*The selection of investment instruments to be allowed for investment purposes is a significant policy issue for many governments. Although day-to-day selection of specific instruments should be treated as a management function, the policy should define the general universe.*

From the governing body perspective, special care must be taken to ensure that the list of instruments includes only those allowed by law and those that local investment managers are trained and competent to handle.

### **SAMPLE LANGUAGE:**

The (entity) is empowered by statute to invest in the following types of securities. (*List types of investments authorized by state/province law, ordinance, or charter. Consider appending copies of these specific requirements to the investment policy.*) (*In selecting authorized investments, consideration should be given to credit ratings on commercial paper, bankers acceptance, and collateralization of applicable instruments*)

### **8.1 Master Repurchase Agreement:** *(maximum points: 10)*

If repurchase agreements are legal and authorized by policy, a Master Repurchase Agreement must be signed with the bank or dealer. (e.g., a *PSA Master Repurchase Agreement* or equivalent)

### **9.0 Investment Pools/Mutual Funds:** *(maximum points: 7)*

#### *Rationale:*

*Governmental sponsored pools and money market mutual funds are excellent short-term cash management facilities. These pools/funds can provide safety, liquidity and yield in a single investment instrument. However, there is a due diligence standard, which applies to the use of pools/funds, as there is no safety net.*

If governmental sponsored pools and/or mutual funds are included in Authorized Investments, a section on investigation and due diligence must be included.

#### **SAMPLE LANGUAGE:**

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. There shall be a questionnaire developed which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc. utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

*NOTE: The topics listed above are not all encompassing, but only a sampling of what might be covered in a questionnaire. APT US&C will be developing a questionnaire in the near future for use when pools/funds are part of the list of Authorized Investments.*

### **10.0 Collateralization:** *(maximum points: 7)*

#### *Rationale:*

*\*Several states require collateralization of all public funds. In these states a collateralization section must be included for any certificates of deposit. In addition, collateralization must be required on any repurchase agreement or reverse repurchase agreement. For these items, the policy should address such points as market valuation responsibility and timing, specific*

*collateral provisions such as type and maturity, safekeeping by a third party, and evidence of ownership.*

**SAMPLE LANGUAGE:**

Collateralization will be required on two types of investments: certificates of deposit and repurchase (and reverse) agreements. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be (102%) of market value of principal and accrued interest.

The entity chooses to limit collateral to the following: – – (*list*) – – Collateral will always be held by an independent third party with whom the entity has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the entity and retained. The right of collateral substitution is granted.

**11.0 Safekeeping and Custody:** (*maximum points: 10*)

*Rationale:*

*\*Like private investors, governing officials feel more secure about their entity's investments if they know that the securities are physically safe. Investment policies should include a clause regarding third-party safekeeping and custody of securities and collateral.*

**SAMPLE LANGUAGE:**

All security transactions, including collateral for repurchase agreements, entered into by the (entity) shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the Treasurer and evidenced by safekeeping receipts.

**12.0 Diversification:** (*maximum points: 7*)

*Rationale:*

*\*...governments should state the purpose of diversification – to reduce overall portfolio risks while attaining benchmark average rate of return. Diversification should be conceptualized in terms of maturity as well as instrument type and issuer. thus, the diversification concept in a cash management fund should include prohibition against over concentration in a specific maturity sector, as well as constraining the reliance on specific risky instruments and issuers.*

**SAMPLE LANGUAGE:**

The (entity) will diversify its investments by security type and institution. With the exception of U.S. Treasury securities and authorized pools, no more than 50% of the (entity's) total investment portfolio will be invested in a single security type or with a single financial institution.

### **13.0 Maximum Maturities:** *(maximum points: 7)*

#### *Rationale*

*\*To protect public funds from market price losses resulting from rising interest rates, some states and many local governments limit the maximum term to maturity on current operating funds' investments, some limit the maximum term to maturity to current operating funds' investments. Some limit the maximum maturity on cash management funds to 12 months. Others find this unduly restrictive and employ a two-year rule. The latter seems reasonable, provided that only a portion of the assets is invested beyond one year.*

#### **SAMPLE LANGUAGE:**

To the extent possible, the *(entity)* will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the *(entity)* will not directly invest in securities maturing more than (\_\_\_\_) years from the date of purchase. However, the *(entity)* may collateralize its repurchase agreements using longer-dated investments not to exceed (\_\_\_\_) years to maturity. Reserve funds may be invested in securities exceeding (\_\_\_\_) years if the maturity of such investments is made to coincide as nearly as practicable with the expected use of the funds.

### **14.0 Internal Control:** *(maximum points: 4)*

#### *Rationale:*

*\*The development of internal controls remains a management function. A statement of investment policy therefore should avoid specific internal control measures. Instead, policy makers should require that a system of internal controls be established. The policy can also provide for periodic reviews and monitoring of the controls. The review of internal controls might be assigned to a committee or to the independent auditor.*

#### **SAMPLE LANGUAGE:**

The Treasurer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

### **15.0 Performance Standards:** *(maximum points: 4)*

#### *Rationale:*

*\*Much of the investment policy focus is directed toward control. Yield objectives are just as important, however. The long-run interests of the jurisdiction go beyond simple prudence and safety of funds. The investment policy should provide a formal evaluation of performance and occasional operational audits.*

#### **SAMPLE LANGUAGE:**

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow needs.

**15.1 Market Yield (Benchmark):** The entity's investment strategy is (*passive or active*). Given this strategy, the basis used by the Treasurer to determine whether market yields is being achieved shall be to identify a comparable benchmark to your portfolio investment duration, *e.g., 90-day US Treasury Bill, 6-month US Treasury Bill, Average Fed Funds Rate.*

**16.0 Reporting:** (*maximum points: 10*)

*Rationale: Periodic required investment reports to policymakers and elected officials provide necessary written communication regarding investment performance, risk analysis, adherence to policy provisions, as well as other information.*

**SAMPLE LANGUAGE:**

The Treasurer shall provide (*the legislative authority*) quarterly investment reports which provide a clear picture of the status of the current investment portfolio. The management report should include comments on the fixed income markets and economic conditions, discussions regarding restrictions on percentage of investment by categories, possible changes in the portfolio structure going forward and thoughts on investment strategies. Schedules in the quarterly report should include the following:

1. A listing of individual securities held at the end of the reporting period by authorized investment category.
2. Average life and final maturity of all investments listed.
3. Coupon, discount or earnings rate.
4. Par value, Amortized Book Value and Market Value.
5. Percentage of the Portfolio represented by each investment category.

*NOTE: Depending on the degree of comprehension of those receiving the reports and their desire, or lack thereof, for detail, you may choose to provide the information in executive summary format.*

**17.0 Investment Policy Adoption:** (*maximum points: 4*)

The (*entity's*) investment policy shall be adopted by resolution of the (*entity's*) legislative authority. The policy shall be reviewed annually by the (*legislative authority*) and any modifications made thereto must be approved by the (*legislative authority*).

**18.0 Glossary:** (*maximum points: 4*)

\*Because this policy is to be available to the public as well as the governing body, it is important that a glossary of related terminology be part of the policy.

*\*Rationale: Adapted from Investing Public Funds, Girard Miller, 1986*

## GLOSSARY

(Note: Entities are encouraged to include a glossary as part of the investment policy. All words of a technical nature should be included. Following is an example of common treasury terminology.)

**AGENCIES:** Federal agency securities and/or Government-sponsored enterprises.

**ASKED:** The price at which securities are offered.

**BANKERS' ACCEPTANCE (BA):** A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

**BENCHMARK:** A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

**BID:** The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

**BROKER:** A broker brings buyers and sellers together for a commission.

**CERTIFICATE OF DEPOSIT (CD):** A time deposit with a specific maturity evidenced by a Certificate. Large-denomination CD's are typically negotiable.

**COLLATERAL:** Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

**COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR):** The official annual report for the \_\_\_\_\_. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

**COUPON:** (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date. **DEALER:** A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

**DEBENTURE:** A bond secured only by the general credit of the issuer.

**DELIVERY VERSUS PAYMENT:** There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

**DERIVATIVES:** (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

**DISCOUNT:** The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

**DISCOUNT SECURITIES:** Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, *e.g.*, U.S. Treasury Bills.

**DIVERSIFICATION:** Dividing investment funds among a variety of securities offering independent returns.

**FEDERAL CREDIT AGENCIES:** Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, *e.g.*, S&L's, small business firms, students, farmers, farm cooperatives, and exporters.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC):** A federal agency that insures bank deposits, currently up to \$100,000 per deposit. **FEDERAL FUNDS RATE:** The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

**FEDERAL HOME LOAN BANKS (FHLB):** Government sponsored wholesale banks (currently 12 regional banks), which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

**FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA):** FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

**FEDERAL OPEN MARKET COMMITTEE (FOMC):** Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

**FEDERAL RESERVE SYSTEM:** The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

**GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae):** Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FmHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

**LIQUIDITY:** A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes. **LOCAL GOVERNMENT INVESTMENT POOL (LGIP):** The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

**MARKET VALUE:** The price at which a security is trading and could presumably be purchased or sold.

**MASTER REPURCHASE AGREEMENT:** A written contract covering all future transactions between the parties to repurchase – reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller borrower.

**MATURITY:** The date upon which the principal or stated value of an investment becomes due and payable.

**MONEY MARKET:** The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

**OFFER:** The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

**OPEN MARKET OPERATIONS:** Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

**PORTFOLIO:** Collection of securities held by an investor.

**PRIMARY DEALER:** A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of

New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

**PRUDENT PERSON RULE:** An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state – the so-called legal list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

**QUALIFIED PUBLIC DEPOSITORIES:** A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

**RATE OF RETURN:** The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

**REPURCHASE AGREEMENT (RP OR REPO):** A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is, increasing bank reserves.

**SAFEKEEPING:** A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

**SECONDARY MARKET:** A market made for the purchase and sale of outstanding issues following the initial distribution.

**SECURITIES & EXCHANGE COMMISSION:** Agency created by Congress to protect investors in securities transactions by administering securities legislation.

**SEC RULE 15C3-1:** See Uniform Net Capital Rule.

**STRUCTURED NOTES:** Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations, which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

**TREASURY BILLS:** A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

**TREASURY BONDS:** Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

**TREASURY NOTES:** Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

**UNIFORM NET CAPITAL RULE:** Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

**YIELD:** The rate of annual income return on an investment, expressed as a percentage. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

Appendix  
*Guidelines for an Investment Procedures Manual*  
For permission to reprint the *Guidelines*, call APT US&C at (301) 495-5560

## **1. Purpose**

The purpose of these guidelines is to help create a Procedures Manual to assist Treasury staff with day-to-day investment operations. As each jurisdiction's investment operations are unique, these guidelines are an outline, with individual items to be added or deleted as necessary or appropriate. *Numerical references and subjects at the beginning of each Section refer to elements in APT's Model Investment Policy.*

## **2. Cash Review**

### *0.0 Policy*

### *1.0 Scope*

### *2.0 Delegation of Authority*

The Treasurer or his/her delegate (hereafter referred to as Investment Officer) must review the cash balances and investment portfolio daily, or as needed. Items to be reviewed should include:

- a) Balances, by fund if so deposited, at primary bank.
- b) Balances, by fund if so deposited, at other banks.
- c) Maturing investments (includes Repo's, CD's, Commercial Paper, Bankers' Acceptances and general securities).
- d) Bond sales and other large, periodic receipts.
- e) Bond and coupon payments (debt service) and other large periodic cash disbursements.

## **3. Investment Selection**

### *3.0 Prudence*

### *4.0 Objective*

### *8.0 Authorized & Suitable Investments*

### *12.0 Diversification*

### *13.0 Maximum Maturities*

The Investment Officer determines how much of the cash balance is available for investment and selects the area of the yield curve that most closely matches the required maturity date. In determining the maturity date, the Investment Officer should consider liquidity, cash flow and expected expenditures. A review of some of the following sources should be made to determine whether the investments should be placed to match projected expenditures or shorter, or to take advantage of current and expected interest rate environments:

- a) Wall Street Journal or similar daily business publication.
- b) Input from approved broker/dealers.

- c) Input from depository banks.
- d) Publications on general trends of economic statistics.
- e) Input from data services (Telerate, Bloomberg, Reuters, etc.)

#### **4. Purchasing an Investment**

*7.0 Authorized Financial Dealers*

*8.0 Authorized & Suitable*

*9.0 Investment Pools*

*10.0 Collateralization & Institutions*

*11.0 Safekeeping & Custody.*

*12.0 Diversification Investments*

*13.0 Maximum Maturities*

Establish with whom the jurisdiction is going to transact business. This should be accomplished through the use of a questionnaire, which helps provide the following evaluation:

- a) Financial condition, strength and capability to fulfill commitments.
- b) Overall reputation with other dealers and investors.
- c) Regulatory status of the broker/dealer (providers).
- d) Background and expertise of the individual representative.

Financial (banking) institutions should be selected through the use of a "Request for Proposal (RFP)." The use of a nationally recognized financial institution rating organization (Lace, Sheshunoff, Thompson Bankwatch, etc.) will assist in the evaluation. Contact an appropriate number of institutions, as specified by policy. The Investment Officer should be as specific as possible in requesting the offering. If a particular type of investment or a particular issuing agency is to be excluded due to policy limitations that should be stated to the providers. If collateral is required (i.e. for Repo's or CD's), the collateral limitations (excess margin, types of securities, maximum maturity, etc.) should be specified.

The following must be determined *prior* to contacting the providers:

- a) Settlement – cash, regular (next day), corporate (3 business days) or when issued if a new issue.
- b) Amount – either par value or total dollars to be invested.
- c) Type of security to be purchased, or type to be excluded.
- d) Targeted maturity, or maturity range.
- e) Time limit to show offering – 5 minutes, 15 minutes, etc.

If choosing an external pool or fund as the preferred investment vehicle, the following should be available for inspection prior to purchase and at any reasonable time thereafter:

- a) A written investment policy, if a government-run investment pool.
- b) A prospectus for money-market funds, mutual funds or bank-managed funds.
- c) A schedule of the types of reports and the frequency of distribution.

- d) A clear description of how interest rates are calculated (30/360, actual/365, etc.)
- e) A schedule of when and how income is distributed.
- f) Are the pool or fund types of investments restricted to your own legal and policy limits?
- g) Are the pool or fund investments restricted to your own maturity limits?

Before concluding the transaction, the Investment Officer should validate the following:

- a) The security selected for purchase meets all criteria, including portfolio diversification, collateralization (if appropriate) and maturity. If the security has any imbedded options such as call provisions or coupon adjustments, these should also be reviewed.
- b) Yield calculations should be verified.
- c) Total purchase cost (including accrued interest) does not exceed funds available for investment.
- d) Advise the successful provider that their offering has been selected for purchase.
- e) After confirmation of the purchase, as a courtesy, notify the other broker/dealers that you have placed the investment. Best price may be disclosed, if you choose.

After consummation of the transaction, and prior to settlement date, the Investment Officer and the provider should exchange and review the following information to ensure prompt, and uninterrupted settlement:

- a) Name of third-party safekeeping agent.
- b) ABA number of safekeeping agent.
- c) Safekeeping account number.
- d) Reconfirm amount of transaction.
- e) Reconfirm settlement date.
- f) Acquire CUSIP number of security, if applicable.

## **5. Settlement & Follow-through**

### ***5.0 Delegation of Authority***

**6.0 The Investment Officer** should forward to the safekeeping agent a report of the investment transaction. The report may be verbal, but a written form should be sent and acknowledged. When applicable, the following should be verified:

- a) Provision of receipt or disbursement of funds.
- b) Internal transfer or wiring of funds.
- c) Validation of written "safekeeping receipt."
- d) Notification of discrepancy prior to acceptance or rejection of the transaction.
- e) Immediate notification if a fail has occurred: by provider if they are responsible, by safekeeping agent if they are responsible.



**APPENDIX B**  
**ATTORNEY GENERAL OPINION NO. 95-807**

TO BE PUBLISHED IN THE OFFICIAL REPORTS

OFFICE OF THE ATTORNEY GENERAL

State of California

DANIEL E. LUNGREN

Attorney General

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OPINION

Of

DANIEL E. LUNGREN  
Attorney General

GREGORY L. GONOT  
Deputy Attorney General

No. 95-807

June 19, 1996

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LAURENCE M. WATSON, ABIDING COUNTY COUNSEL, COUNTY OF ORANGE, has requested an opinion on the following question:

May the treasurer of a general law county grant to a contract investment manager, who is not a deputy of the treasurer, discretionary authority to invest funds on deposit with the treasurer?

CONCLUSION

The treasurer of a general law county may grant to a contract investment manager, who is not a deputy of the treasurer, discretionary authority to invest funds on deposit with the treasurer, provided that the treasurer exercises prudence in the selection of the manager and imposes suitable safeguards to prevent abuse in the exercise of discretion by the manager. The treasurer would remain responsible for any investment decisions made by the manager.

95-807

## ANALYSIS

The question presented for resolution concerns the ability of a county treasurer to contract with an investment manager for the purpose of investing funds which are in the custody of the treasurer. The manager would select, purchase, and sell individual securities. We conclude that such an arrangement would not violate state law if the treasurer exercises prudence in the selection of the manager and imposes safeguards to prevent abuse in the exercise of discretion by the manager. The treasurer would remain responsible for any investment decisions made by the manager.

Government Code section 27000<sup>1</sup> provides that "[the] county treasurer shall receive and keep safe all money belonging to the county and all other money directed by law to be paid to him and apply and pay it out, rendering the account as required by law." Section 27000.1 states:

"The board of supervisors may, by ordinance, delegate to the county treasurer the authority to invest or reinvest the funds of the county and funds of other depositors in the county treasury . . . . The county treasurer shall thereafter assume full responsibility for those transactions until the board of supervisors, by ordinance, revokes its delegation of authority...."

Section 27000.3 provides:

"The county treasurer is a trustee and therefore a fiduciary subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, the county treasurer shall act with care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the county and the other depositors. Within the limitations of this section and considering individual investments as part of an overall investment strategy, a trustee is authorized to acquire investments as authorized by law. Nothing in this chapter is intended to grant investment authority to any person or governing body except as provided in Sections 53601, 53607, and 53635."<sup>2</sup>

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<sup>1</sup> All section references are to the Government Code unless otherwise indicated.

<sup>2</sup> The requirements of sections 53607 and 53635 are discussed below.

Section 27000.5 states:

"When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, the primary objective of the county treasurer shall be to safeguard the principal of the funds under his or her control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under his or her control."

When a county invests surplus funds, the board of supervisors must establish a county treasury oversight committee. (§ 25131.) The treasurer must annually prepare for the committee an investment policy which includes:

"(a) A list of securities or other instruments in which the county treasurer may invest, according to law, including the maximum allowable percentage by type of security.

"(b) The maximum term of any security purchased by the county treasury.

"(c) The criteria for selecting security brokers and dealers from, to, or through whom the county treasury may purchase or sell securities or other instruments. The criteria shall prohibit the selection of any broker, brokerage, dealer, or securities firm that has, within any consecutive 48-month period following January 1, 1996, made a political contribution in an amount exceeding the limitations contained in Rule-G37 of the Municipal Securities Rulemaking Board, to the local treasurer, any member of the governing board of the local agency, or any candidate for those offices.

" ..... " (§ 27133.)

While the committee has oversight responsibility, it may not "direct individual investment decisions, select individual investment advisors brokers, or dealers, or impinge on the day-to-day operations of the county treasury." (§ 27137.)

Historically the Legislature placed numerous restrictions upon the investment of local public funds. (See Stats. 1967, ch. 1026, § 1; Stats. 1949, ch. 81, § 1.) Differing requirements were made applicable to the investment of local funds needed for immediate use, surplus funds needed for future use, and specialized funds such as those contributed under an employee deferred compensation plan. (See 57 Ops.Cal.Atty.Gen. 534, 539-542 (1974).) Recently investment opportunities have been broadened by the Legislature and given substantially similar treatment. (See, e.g., §§ 53601, 53609, 53635.)

We may assume for our purposes that the county treasurer has been given the necessary authority by the board of supervisors to invest the county's funds, that a county treasury oversight committee has been established in the county, and that the treasurer will comply with all statutory requirements relating to the investment of the funds.

Except insofar as the treasurer's powers may be exercised by a deputy<sup>3</sup>, the governing statutes do not expressly provide for any further grant of discretion with respect to the investment of county funds. Here we are given that the manager would not be a deputy of the treasurer. Since no express statutory authority allows a treasurer to grant discretion regarding investment decisions to such an "outside" manager, may the authority to do so be implied? We believe the answer to this question may be determined by examining the scope of the treasurer's authority as a trustee of the county's funds.

Section 27000.3 denominates the treasurer as a "trustee," thereby making him "a fiduciary subject to the prudent investor standard." The prudent investor standard is set forth in the Restatement Third of Trusts section 227. As applicable herein, section 227 states:

"The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.

". . . . .

"(c) In addition, the trustee must:

"(1) conform to fundamental fiduciary duties of loyalty (§ 170) and impartiality (§ 183);

"(2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents (§ 171); and

"(3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship (§ 188).

"(d) The trustee's duties under this Section are subject to the rule of § 228, dealing primarily with contrary investment provisions of a trust or statute."

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<sup>3</sup> The county treasurer "may appoint as many deputies as are necessary for the prompt and faithful discharge of the duties of his office." (§ 24101.) Whenever the official name of any principal officer is used in any law conferring power or imposing duties or liabilities, it includes deputies. (§ 24100; see also §§ 7, 1194; 70 Ops.Cal.Atty.Gen. 710, 715, 718-719 (1980).)

The Restatement rule, section 171, governing a trustee's authority in granting discretion to others in performing his responsibilities is as follows:

"A trustee has a duty personally to perform the responsibilities of the trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances."

A comment to this Restatement rule explains "fiduciary duty" and "discretion" as regards a delegation of responsibility:

"A trustee stands in a fiduciary relationship to the beneficiaries of the trust and therefore is under a duty personally to perform the responsibilities of the trusteeship except as it would be prudent, under the circumstances, to delegate to agents *the making of decisions* or the performance of acts of administration." (§ 171, com. a; emphasis added.)

The prudent investor standard is also set forth in the Uniform Prudent Investor Act (Prob. Code, §§ 16045-16054). Probate Code section 16052, subdivision (a), states:

"A trustee may delegate investment and management functions as prudent under the circumstances. The trustee shall exercise prudence in the following:

"(1) Selecting an agent.

"(2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust.

"(3) Periodically reviewing the agent's overall performance and compliance with the terms of the delegation."<sup>4</sup>

The use of agents by a trustee may be necessary because "[m]any duties of the trustee require special skills and knowledge which the trustee does not possess so that he could not be expected to perform such work without advice and aid." (Bogert, Trusts (6th ed. 1987) § 92, p. 331.) In a comment regarding the prudent

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<sup>4</sup> A county treasurer's conduct may be measured under the principles applicable to trustees expressed in the Probate Code. (See Prob. Code, § 15003, subd. (c).)

investor standard, the Restatement Third of Trusts states:

"The trustee is not required personally to perform all aspects of the investment function. *The trustee must not, however, abdicate the responsibilities of the office* and must not delegate unreasonably. Prudent behavior in this matter, as in other aspects of prudent investment management, cannot be reduced to a simple, objective formula.

"With professional advice as needed, the trustee personally must define the trust's investment objectives. The trustee must also make the decisions that establish the trust's investment strategies and programs, at least to the extent of approving plans developed by agents or advisers. Beyond these generalizations, expressed in terms that are necessarily imprecise, there is no invariant formula concerning functions that are to be performed by the trustee personally.

"Many factors affect the nature and extent of prudent and therefore permissible delegation. These factors include the almost infinite variety that exists in trustees and trusteeships, as well as in investment objectives and techniques and in the types, circumstances, and goals of trusts. For example, it would be impractical for delegation decisions not to take account of the scale of a trust's operations and the nature of the trustee's operating structure. Corporate trustees necessarily act through their employees; between that situation and the individual who acts as a trustee or co-trustee, however, there are many variations of trusteeship, encompassing, for example, *institutional governing bodies*, law firms, and panels of individuals operating with the support of full-time staff.

"The trustee's authority to delegate is not confined to acts that might reasonably be described as 'ministerial.' Nor is delegation precluded because the act in question calls for the exercise of considerable judgment or discretion. The trustee's decisions with regard to delegation are themselves matters of fiduciary judgment and responsibility falling within the sound discretion of the trustee.

"As in other matters of fiduciary discretion . . . , the trustee must not abuse the discretion to delegate. Accordingly, a court may substitute its judgment for that of the trustee in a matter of delegation if and only if the trustee has acted unreasonably, or has unreasonably failed to act. Similarly,

a trustee's liability in a matter of delegation depends on a failure to exercise the required degree of care, skill, or caution.

"In deciding what as well as whether to delegate and in selecting, instructing, and supervising agents, the trustee has a duty to the beneficiaries to act as a prudent investor would act under the circumstances. *The trustee must exercise care, skill, and caution in establishing the scope and specific terms of any delegation, and must keep reasonably informed in order to monitor the execution of investment decisions or plans.*

"In all of these matters the trustee has a duty to the beneficiaries to take account of all relevant circumstances. These include the *knowledge, skill, facilities, and compensation of both the trustee and the prospective agents.* Also of importance are such considerations as the *size of the trust estate and the burdens and complexity of both the assets to be managed and the strategies to be implemented.* Active investment strategies, for example, especially in low efficiency markets such as real estate and venture capital, are likely to require the hiring of agents with special skills not possessed by many trustees, often not even by professional or corporate fiduciaries." (§ 227, com. j, pp. 39-40, emphasis added.)

The prudent investor standard requires a trustee to act in accordance with applicable statutes. Section 228 of the Restatement Third of Trusts provides:

"In investing the funds of the trust, the trustee

"(a) has a duty to the beneficiaries to conform to any applicable statutory provisions governing investment by trustees ...."

As previously indicated, upon receiving authority from the board of supervisors to invest county funds, the treasurer assumes full responsibility for that function. (§ 27000.1.) However, it is contemplated by the Legislature that the treasurer, in making investments for the county (§ 53607), will employ necessary financial advisors, consultants, and managers in carrying out his responsibilities. Section 53635, for example, provides in part:

". . . A local agency purchasing or obtaining any securities described in this section, in a negotiable, bearer, registered, or nonregistered format, shall require delivery of all the securities to the local agency, *including those purchased for the agency by financial advisors, consultants, or managers using*

*the agency's funds*, by book entry, physical delivery, or by third-party custodial agreement...." (Emphasis added.)<sup>5</sup>

We believe that given (1) the relatively large amount of funds which may be administered by a county treasurer, (2) the degree of skill required for investing in the complex forms of securities described in section 53635, (3) the section 27133 requirement for annual preparation by the treasurer of an investment policy to control investment decisions (including the maximum allowable percentage by type of security), and (4) the section 27134 requirement for an annual audit which "may include issues relating to the structure of the investment portfolio and risk," a county treasurer may grant the authority in question under the prudent investor standard, assuming he has exercised prudence in the selection of the manager and has imposed suitable safeguards to prevent abuse in the exercise of discretion by the manager. Of course, in contra; with an investment manager, the treasurer may not abdicate his responsibility for the investment of county funds.

We conclude that the treasurer of a general law county may grant to a contract investment manager, who is not a deputy of the treasurer, discretionary authority to invest funds on deposit with the treasurer provided that the treasurer exercises prudence in the selection of the manager and imposes suitable safeguards to prevent abuse in the exercise of discretion by the manager. The trustee would remain responsible for any investment decisions made by the manager.

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<sup>5</sup> Wholly aside from the issue of granting discretion to a manager to invest county funds we note that a county board of supervisors may contract for investment advice under the terms of section s3060:

"The legislative body of any public or municipal corporation or district may contract with and employ any persons for the furnishing to the corporation or district special services and advise in financial, economic, accounting, engineering, legal, or administrative matters if such persons are specially trained and experienced and compensation to perform the special services required.

"..... .

"The legislative body of the corporation or district may pay from any available funds such compensation to such persons as it deems proper for the services rendered."



**APPENDIX C**  
**KEY GOVERNMENT CODE SECTIONS**

## **GOVERNMENT CODE**

### **SECTION 16429.1-16429.4**

16429.1. (a) There is in trust in the custody of the Treasurer the Local Agency Investment Fund, which fund is hereby created. The Controller shall maintain a separate account for each governmental unit having deposits in this fund.

(b) Notwithstanding any other provisions of law, a local governmental official, with the consent of the governing body of that agency, having money in its treasury not required for immediate needs, may remit the money to the Treasurer for deposit in the Local Agency Investment Fund for the purpose of investment.

(c) Notwithstanding any other provisions of law, an officer of any nonprofit corporation whose membership is confined to public agencies or public officials, or an officer of a qualified quasi-governmental agency, with the consent of the governing body of that agency, having money in its treasury not required for immediate needs, may remit the money to the Treasurer for deposit in the Local Agency Investment Fund for the purpose of investment.

(d) Notwithstanding any other provision of law or of this section, a local agency, with the approval of its governing body, may deposit in the Local Agency Investment Fund proceeds of the issuance of bonds, notes, certificates of participation, or other evidences of indebtedness of the agency pending expenditure of the proceeds for the authorized purpose of their issuance. In connection with these deposits of proceeds, the Local Agency Investment Fund is authorized to receive and disburse moneys, and to provide information, directly with or to an authorized officer of a trustee or fiscal agent engaged by the local agency, the Local Agency Investment Fund is authorized to hold investments in the name and for the account of that trustee or fiscal agent, and the Controller shall maintain a separate account for each deposit of proceeds.

(e) The local governmental unit, the nonprofit corporation, or the quasi-governmental agency has the exclusive determination of the length of time its money will be on deposit with the Treasurer.

(f) The trustee or fiscal agent of the local governmental unit has the exclusive determination of the length of time proceeds from the issuance of bonds will be on deposit with the Treasurer.

(g) The Local Investment Advisory Board shall determine those quasi-governmental agencies which qualify to participate in the Local Agency Investment Fund.

(h) The Treasurer may refuse to accept deposits into the fund if, in the judgment of the Treasurer, the deposit would adversely affect the state's portfolio.

(i) The Treasurer may invest the money of the fund in securities prescribed in Section 16430. The Treasurer may elect to have the money of the fund invested through the Surplus Money Investment Fund as provided in Article 4 (commencing with Section 16470) of Chapter 3 of Part 2 of Division 4 of Title 2.

(j) Money in the fund shall be invested to achieve the objective of the fund which is to realize the maximum return consistent with safe and prudent treasury management.

(k) All instruments of title of all investments of the fund shall remain in the Treasurer's vault or be held in safekeeping under control of the Treasurer in any federal reserve bank, or any branch thereof, or the Federal Home Loan Bank of San Francisco, with any trust company, or the trust department of any state or national bank.

(l) Immediately at the conclusion of each calendar quarter, all interest earned and other increment derived from investments shall be distributed by the Controller to the contributing governmental units or trustees or fiscal agents, nonprofit corporations, and quasi-governmental

agencies in amounts directly proportionate to the respective amounts deposited in the Local Agency Investment Fund and the length of time the amounts remained therein. An amount equal to the reasonable costs incurred in carrying out the provisions of this section, not to exceed a maximum of one-half of 1 percent of the earnings of this fund, shall be deducted from the earnings prior to distribution. The amount of this deduction shall be credited as reimbursements to the state agencies, including the Treasurer, the Controller, and the Department of Finance, having incurred costs in carrying out the provisions of this section.

(m) The Treasurer shall prepare for distribution a monthly report of investments made during the preceding month.

(n) As used in this section, "local agency," "local governmental unit," and "local governmental official" includes a campus or other unit and an official, respectively, of the California State University who deposits moneys in funds described in Sections 89721, 89722, and 89725 of the Education Code.

16429.2. There is created the Local Investment Advisory Board consisting of five members. The chairman shall be the State Treasurer or his or her designated representative. Two members who are qualified by training and experience in the field of investment or finance, shall be appointed by the State Treasurer. Two members who are treasurers, finance or fiscal officers or business managers, employed by any county, city or local district or municipal corporation of this state, shall be appointed by the Treasurer.

The term of office of each appointed member of the board is two years, but each appointed member serves at the pleasure of the appointing authority. A vacancy in the appointed membership, occurring other than by expiration of term, shall be filled in the same manner as the original appointment, but for the unexpired term only.

Members of the board who are not state officers or employees shall not receive a salary, but shall be entitled to a per diem allowance of fifty dollars (\$50) for each day's attendance at a meeting of the board, not to exceed three hundred dollars (\$300) in any month. All members shall be entitled to reimbursement for expenses incurred in the performance of their duties under this part, including travel and other necessary expenses.

The board's primary purpose shall be to advise and assist the State Treasurer in formulating the investment and reinvestment of moneys in the Local Agency Investment Fund, and the acquisition, retention, management, and disposition of investments of the fund. The board, from time to time, shall review those policies and advise therein as it considers necessary or desirable. The board shall advise the State Treasurer in the management of the fund and consult the State Treasurer on any matter relating to the investment and reinvestment of moneys in the fund.

16429.3. Moneys placed with the Treasurer for deposit in the Local Agency Investment Fund by cities, counties, special districts, nonprofit corporations, or qualified quasi-governmental agencies shall not be subject to either of the following:

- (a) Transfer or loan pursuant to Sections 16310, 16312, or 16313.
- (b) Impoundment or seizure by any state official or state agency.

16429.4. The right of a city, county, city and county, special district, nonprofit corporation, or qualified quasi-governmental agency to withdraw its deposited moneys from the Local Agency Investment Fund, upon demand, may not be altered, impaired, or denied, in any way, by any

state official or state agency based upon the state's failure to adopt a State Budget by July 1 of each new fiscal year.

## **GOVERNMENT CODE**

### **SECTION 16481.2**

16481.2. (a) The Treasurer shall annually prepare and submit to the Pooled Money Investment Board a written statement of investment policy. The Treasurer shall promptly notify the board of any material change in the statement of investment policy. The board shall consider the statement of investment policy and any changes therein at a public meeting.

(b) In addition to the report required by Section 16480.7, the Treasurer shall submit a quarterly report to the Pooled Money Investment Board within 30 days following the end of the quarter covered by the report containing the following:

(1) The type of investment, name of the issuer, date of maturity, par and dollar amount invested in each security, investment, and money within the treasury.

(2) The weighted average maturity of the investments within the treasury.

(3) Any funds, investments, or programs, including loans, that are under the management of contracted parties.

(4) The market value as of the date of the report, and the source of this valuation for any security within the treasury.

(5) A description of the compliance with the statement of investment policy.

(c) The board may, by resolution, require the treasurer to report the information required in subdivision (b) every month rather than quarterly.

## **GOVERNMENT CODE**

### **SECTION 27000-27013**

27000. The county treasurer shall receive and keep safely all money belonging to the county and all other money directed by law to be paid to him and apply and pay it out, rendering the account as required by law.

27000.1. Subject to Section 53607, the board of supervisors may, by ordinance, delegate to the county treasurer the authority to invest or reinvest the funds of the county and the funds of other depositors in the county treasury, pursuant to Chapter 4 (commencing with Section 53600) of Part 1 of Division 2 of Title 5. The county treasurer shall thereafter assume full responsibility for those transactions until the board of supervisors either revokes its delegation of authority, by ordinance, or decides not to renew the annual delegation, as provided in Section 53607. Nothing in this section shall limit the county treasurer's authority pursuant to Section 53635 or 53684.

27000.3. (a) With regard to county funds deposited in the county treasury, the board of supervisors is the agent of the county who serves as a fiduciary and is subject to the prudent investor standard, unless a delegation has occurred pursuant to Section 53607 in which case the county treasurer shall be the agent of the county with respect to these funds, serve as a fiduciary, and be subject to the prudent investor standard and the board of supervisors shall not be the agent, serve as a fiduciary, or be subject to the prudent investor standard.

(b) With regard to funds deposited in the county treasury that are deposited by local agencies other than the county and at the discretion of those local agencies, the county treasurer serves as a fiduciary subject to the prudent investor standard.

(c) When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the county treasurer or the board of supervisors, as applicable, shall act with care, skill, prudence, and diligence under the circumstances then prevailing, specifically including, but not limited to, the general economic conditions and the anticipated needs of the county and other depositors, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the county and the other depositors. Within the limitations of this section and considering individual investments as part of an overall investment strategy, investments may be acquired as authorized by law. Nothing in this chapter is intended to grant investment authority to any person or governing body except as provided in Sections 53601, 53607, and 53635.

27000.5. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of the county treasurer or the board of supervisors, as the case may be, shall be to safeguard the principal of the funds under the treasurer's or the board's control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under his or her control.

27000.6. The provisions of Sections 27000.7, 27000.8, and 27000.9 shall become effective only in those counties in which, prior to the first date of the period for filing declarations of candidacy for the office of county treasurer, county tax collector, or county treasurer-tax collector, the board of supervisors by majority vote at a regular meeting with all members present, enact an

ordinance adopting the provisions of those sections. That ordinance may be repealed by the board of supervisors at any time.

27000.7. (a) No person shall be eligible for election or appointment to the office of county treasurer, county tax collector, or county treasurer-tax collector of any county unless that person meets at least one of the following criteria:

(1) The person has served in a senior financial management position in a county, city, or other public agency dealing with similar financial responsibilities for a continuous period of not less than three years, including, but not limited to, treasurer, tax collector, auditor, auditor-controller, or the chief deputy or an assistant in those offices.

(2) The person possesses a valid baccalaureate, masters, or doctoral degree from an accredited college or university in any of the following major fields of study: business administration, public administration, economics, finance, accounting, or a related field, with a minimum of 16 college semester units, or their equivalent, in accounting, auditing, or finance.

(3) The person possesses a valid certificate issued by the California Board of Accountancy pursuant to Chapter 1 (commencing with Section 5000) of Division 3 of the Business and Professions Code, showing that person to be, and a permit authorizing that person to practice as, a certified public accountant.

(4) The person possesses a valid charter issued by the Institute of Chartered Financial Analysts showing the person to be designated a Chartered Financial Analyst, with a minimum of 16 college semester units, or their equivalent, in accounting, auditing, or finance.

(5) The person possesses a valid certificate issued by the Treasury Management Association showing the person to be designated a Certified Cash Manager, with a minimum of 16 college semester units, or their equivalent, in accounting, auditing, or finance.

(b) This section shall only apply to any person duly elected or appointed as a county treasurer, county tax collector, or county treasurer-tax collector on or after January 1, 1998.

27000.8. Any duly elected county treasurer, county tax collector, or county treasurer-tax collector serving in that office on January 1, 1996, may serve for his or her remaining term of office during which period of time the requirements of this section shall not apply. After the election of a county treasurer, county tax collector, or county treasurer-tax collector to office, that person shall complete a valid continuing course of study as prescribed in this section, and shall during the person's four-year term of office on or before June 30 of the fourth year, render to the State Controller a certification indicating that the person has successfully completed a continuing education program consisting of, at a minimum, 48 hours, or an equivalent amount of continuing education units within the discipline of treasury management, public finance, public administration, governmental accounting, or directly related subjects, offered by a recognized state or national association, institute, or accredited college or university, or the California Debt and Investment Advisory Commission, that provides the requisite educational programs prescribed in this section. The willful or negligent failure of any elected county treasurer, county tax collector, or county treasurer-tax collector to comply with the requirements of this section shall be deemed a violation of this section.

27000.9. Notwithstanding any other requirement of law, any duly appointed county officer serving in the capacity of county treasurer, county tax collector, or county treasurer-tax collector shall, beginning in 2000, complete a valid continuing course of study as prescribed in this

section, and shall, on or before June 30 of each two-year period, render to the State Controller, a certification indicating that the county officer has successfully completed a continuing education program consisting of, at a minimum, 24 hours or an equivalent amount of continuing education units within the discipline of treasury management, public finance, public administration, governmental accounting, or directly related subjects, offered by a recognized state or national association, institute, or accredited college or university, or the California Debt and Investment Advisory Commission, that provides the requisite educational programs prescribed in this section. The willful or negligent failure of any county officer serving in the capacity of county treasurer, county tax collector, or county treasurer-tax collector to comply with the requirements of this section shall be deemed a violation of this section.

27001. The treasurer shall file and keep the certificates of the auditor delivered to him or her when money is paid into the treasury.

Notwithstanding Sections 26201, 26202, and 26205, the treasurer may destroy any certificate pursuant to this section under either of the following circumstances:

- (a) The certificate has been filed for more than five years.
- (b) The certificate has been filed for more than one year, and all of the following conditions are complied with:
  - (1) The record, paper, or document is photographed, microphotographed, or reproduced on film of a type approved for permanent photographic records by the National Bureau of Standards.
  - (2) The device used to reproduce the record, paper, or document on film is one that accurately reproduces the original thereof in all details.
  - (3) The photographs, microphotographs, or other reproductions on film are placed in conveniently accessible files and provision is made for preserving, examining, and using the same.
  - (4) The record, paper, or document is reproduced and preserved utilizing other information technology .

27002. The treasurer shall keep an account of the receipt and expenditure of all money received or paid out by him or her in books provided for the purpose. He or she shall enter in the books the amount, the time, from whom, and on what account all money was received by him or her, and the warrant number, the amount, time, and on what account all disbursements were made by him or her.

27002.1. (a) The treasurer may, in lieu of entering in books an account of the receipt and expenditure of all money received or paid out by him or her as provided in Section 27002, photograph, microphotograph, photocopy, or enter into an electronic data-processing system that utilizes optical transmission and filing, all receipts for money received by him or her and all warrants paid out by him or her.

(b) Every reproduction described in subdivision (a) shall be deemed and considered an original, and a transcript, exemplification, or certified copy of any of those reproductions shall be deemed and considered a transcript, exemplification, or certified copy, as the case may be, of the original.

(c) All reproductions described in subdivision (a) shall be properly indexed and placed in convenient, accessible files. Each roll of microfilm shall be deemed and constitute a book, and

shall be designated and numbered, and provision shall be made for preserving, examining, and using it. A duplicate of each roll of microfilm shall be made and kept in a safe and separate place.

27003. The treasurer shall keep his or her books or any other authorized form of record so that the amounts received and paid out on account of separate funds or specific appropriations are exhibited in separate and distinct accounts, and the whole receipts and expenditures shown in one general or cash account.

27005. The treasurer shall disburse the county money and all other money placed in his or her custody by official authority only on county warrants, checks, or electronic fund transfers issued by the county auditor, except for the making of legal investments.

27006. The treasurer shall disburse the money in the treasury on county warrants only when they are based on orders of the board of supervisors, upon order of the superior court, or as otherwise provided by law. In the payment of the warrants he may issue his order, check, or draft drawn upon proper funds that are on deposit in any bank.

27007. The treasurer shall keep all money belonging to the State, or any county of the State in his own possession until disbursed according to law. He shall not place the money in the possession of any person to be used for any purpose, nor shall he loan or in any manner use, or permit any person to use it, except as provided by law. This section does not prohibit him from making special deposits for the safe-keeping of public money, but he is liable therefore on his official bond.

27008. (a) The treasurer shall not receive money into the treasury or for deposit with him or her as treasurer, unless it is accompanied by the certificate of the auditor.

(b) Notwithstanding subdivision (a), the auditor and treasurer may establish alternate control procedures for the treasurer to receive or deposit money without the certificate of the auditor.

27009. The treasurer shall give a receipt to each person who deposits money into the county treasury.

27010. The treasurer may receive any money constituting gift, bequest, or devise, and pay it out in accordance with the terms thereof, or, if none are fixed, according to law.

27011. Any county officer who knowingly accepts or allows any deposit in the county treasury of money from any private and unofficial source is guilty of a misdemeanor, punishable by imprisonment in the county jail for not less than six months nor more than one year, or by a fine of not less than five hundred dollars (\$500) and not more than five thousand dollars (\$5,000), or by both that fine and imprisonment, and shall forfeit his or her office.

27012. The Controller may summon county treasurers or the authorized representative of any county treasurer to meet with the Controller or his or her duly authorized representatives, in those groups and at that place or those places within the state as may be designated by the Controller for the purpose of discussing the interpretation, procedures, uniformity of operation,

and efficient administration of the Revenue and Taxation Code and the Government Code. The actual and necessary expenses of any county officer or his or her authorized representative that are incurred while traveling to and from or while attending any meeting called pursuant to this section by the Controller shall be a charge against the county, to be paid in the same manner as other county charges are paid, provided that prior approval of the board of supervisors has been obtained.

27013. Notwithstanding any other provision of law, any treasurer, or other authorized county officer, who invests, deposits or otherwise handles funds for public agencies for the purpose of earning interest or other income on such funds as permitted by law, may deduct from such interest or income, before distribution thereof, the actual administrative cost of such investing, depositing or handling of funds and of distribution of such interest or income. Such cost reimbursement shall be paid into the county general fund.

## **GOVERNMENT CODE**

### **SECTION 27130-27137**

27130. The Legislature finds and declares that local agencies, including school districts, should participate in reviewing the policies that guide the investment of those funds. The Legislature further finds and declares that by pooling deposits from local agencies and other participants, county treasuries operate in the public interest when they consolidate banking and investment activities, reduce duplication, achieve economies of scale, and carry out coherent and consolidated investment strategies. The Legislature further finds and declares that the creation of county treasury oversight committees will promote the public interest by involving depositors in the management of their funds and by enhancing the security and investment return on their funds by providing a more stable and predictable balance for investment by establishing criteria for the withdrawal of funds.

27131. (a) The board of supervisors in each county or city and county may, if the county or city and county is investing surplus funds, establish a county treasury oversight committee. The board of supervisors, in consultation with the county treasurer, shall determine the exact size of the committee, which shall consist of from 3 to 11 members, and the categories from which the members shall be represented, as specified in subdivisions (a) to (g), inclusive, of Section 27132. Members shall be nominated by the treasurer and confirmed by the board of supervisors.

(b) In recognition of the state and local interests served by the action made optional in subdivision (a), the Legislature encourages local agencies to continue taking the action formerly mandated by this section. However, nothing in this subdivision may be construed to impose any liability on a local agency that does not continue to take the formerly mandated action.

27132. The county treasury oversight committee, pursuant to Section 27131, shall consist of members appointed from the following:

- (a) The county treasurer.
- (b) The county auditor, auditor-controller, or finance director, as the case may be.
- (c) A representative appointed by the county board of supervisors.
- (d) The county superintendent of schools or his or her designee.
- (e) A representative selected by a majority of the presiding officers of the governing bodies of the school districts and community college districts in the county.
- (f) A representative selected by a majority of the presiding officers of the legislative bodies of the special districts in the county that are required or authorized to deposit funds in the county treasury.
- (g) Up to five other members of the public.
  - (1) A majority of the other public members shall have expertise in, or an academic background in, public finance.
  - (2) The other public members shall be economically diverse and bipartisan in political registration.

27132.1. A member may not be employed by an entity that has (a) contributed to the campaign of a candidate for the office of local treasurer, or (b) contributed to the campaign of a candidate to be a member of a legislative body of any local agency that has deposited funds in the county

treasury, in the previous three years or during the period that the employee is a member of the committee.

27132.2. A member may not directly or indirectly raise money for a candidate for local treasurer or a member of the governing board of any local agency that has deposited funds in the county treasury while a member of the committee.

27132.3. A member may not secure employment with, or be employed by, bond underwriters, bond counsel, security brokerages or dealers, or financial services firms, with whom the treasurer is doing business during the period that the person is a member of the committee or for one year after leaving the committee.

27132.4. Committee meetings shall be open to the public and subject to the Ralph M. Brown Act (Chapter 9 (commencing with Section 54950) of Part 1 of Division 2 of Title 5).

27133. In any county that establishes a county treasury oversight committee pursuant to this article, the county treasurer shall annually prepare an investment policy that will be reviewed and monitored by the county treasury oversight committee. The investment policy shall include all of the following:

- (a) A list of securities or other instruments in which the county treasury may invest, according to law, including the maximum allowable percentage by type of security.

- (b) The maximum term of any security purchased by the county treasury.

- (c) The criteria for selecting security brokers and dealers from, to, or through whom the county treasury may purchase or sell securities or other instruments. The criteria shall prohibit the selection of any broker, brokerage, dealer, or securities firm that has, within any consecutive 48-month period following January 1, 1996, made a political contribution in an amount exceeding the limitations contained in Rule G-37 of the Municipal Securities Rulemaking Board, to the local treasurer, any member of the governing board of the local agency, or any candidate for those offices.

- (d) Limits on the receipt of honoraria, gifts, and gratuities from advisors, brokers, dealers, bankers, or other persons with whom the county treasury conducts business by any member of the county treasury oversight committee. These limits may be in addition to the limits set by a committee member's own agency, by state law, or by the Fair Political Practices Commission.

- (e) A requirement that the county treasurer provide the county treasury oversight committee with an investment report as required by the board of supervisors.

- (f) The manner of calculating and apportioning the costs, authorized by Section 27013, of investing, depositing, banking, auditing, reporting, or otherwise handling or managing funds.

- (g) The terms and conditions under which local agencies and other entities that are not required to deposit their funds in the county treasury may deposit funds for investment purposes.

- (h) Criteria for considering requests to withdraw funds from the county treasury, pursuant to Section 27136. The criteria shall include an assessment of the effect of a proposed withdrawal on the stability and predictability of the investments in the county treasury.

27134. The county treasury oversight committee shall cause an annual audit to be conducted to determine the county treasury's compliance with this article. The audit may include issues relating to the structure of the investment portfolio and risk.

27135. The costs of complying with this article shall be county charges and may be included with those charges enumerated under Section 27013.

27136. (a) Notwithstanding any other provision of law, any local agency, public agency, public entity, or public official that has funds on deposit in the county treasury pool and that seeks to withdraw funds for the purpose of investing or depositing those funds outside the county treasury pool, shall first submit the request for withdrawal to the county treasurer before withdrawing funds from the county treasury pool.

(b) The county treasurer shall evaluate each proposed withdrawal for its consistency with the criteria adopted pursuant to subdivision (h) of Section 27133. Prior to approving a withdrawal, the county treasurer shall find that the proposed withdrawal will not adversely affect the interests of the other depositors in the county treasury pool.

27137. Nothing in this article shall be construed to allow the county treasury oversight committee to direct individual investment decisions, select individual investment advisors, brokers, or dealers, or impinge on the day-to-day operations of the county treasury.

## **GOVERNMENT CODE**

### **SECTION 53600-53609**

53600. As used in this article, "local agency" means county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.

53600.3. Except as provided in subdivision (a) of Section 27000.3, all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

53600.5. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of a trustee shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under its control.

53600.6. The Legislature hereby finds that the solvency and creditworthiness of each individual local agency can impact the solvency and creditworthiness of the state and other local agencies within the state. Therefore, to protect the solvency and creditworthiness of the state and all of its political subdivisions, the Legislature hereby declares that the deposit and investment of public funds by local officials and local agencies is an issue of statewide concern.

53601. This section shall apply to a local agency that is a city, a district, or other local agency that does not pool money in deposits or investments with other local agencies, other than local agencies that have the same governing body. However, Section 53635 shall apply to all local agencies that pool money in deposits or investments with other local agencies that have separate governing bodies. The legislative body of a local agency having money in a sinking fund or money in its treasury not required for the immediate needs of the local agency may invest any portion of the money that it deems wise or expedient in those investments set forth below. A local agency purchasing or obtaining any securities prescribed in this section, in a negotiable, bearer, registered, or nonregistered format, shall require delivery of the securities to the local agency, including those purchased for the agency by financial advisers, consultants, or managers using the agency's funds, by book entry, physical delivery, or by third-party custodial agreement. The transfer of securities to the counterparty bank's customer book entry account may be used for book entry delivery.

For purposes of this section, "counterparty" means the other party to the transaction. A counterparty bank's trust department or separate safekeeping department may be used for the physical delivery of the security if the security is held in the name of the local agency. Where

this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security, other than a security underlying a repurchase or reverse repurchase agreement or securities lending agreement authorized by this section, that at the time of the investment has a term remaining to maturity in excess of five years, unless the legislative body has granted express authority to make that investment either specifically or as a part of an investment program approved by the legislative body no less than three months prior to the investment:

(a) Bonds issued by the local agency, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.

(b) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.

(d) Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

(e) Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

(f) Bankers acceptances otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank. Purchases of bankers acceptances may not exceed 180 days' maturity or 40 percent of the agency's money that may be invested pursuant to this section. However, no more than 30 percent of the agency's money may be invested in the bankers acceptances of any one commercial bank pursuant to this section.

This subdivision does not preclude a municipal utility district from investing any money in its treasury in any manner authorized by the Municipal Utility District Act (Division 6 (commencing with Section 11501) of the Public Utilities Code).

(g) Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or paragraph (2):

(1) The entity meets the following criteria:

(A) Is organized and operating in the United States as a general corporation.

(B) Has total assets in excess of five hundred million dollars (\$500,000,000).

(C) Has debt other than commercial paper, if any, that is rated "A" or higher by a nationally recognized statistical-rating organization (NRSRO).

(2) The entity meets the following criteria:

(A) Is organized within the United States as a special purpose corporation, trust, or limited liability company.

(B) Has programwide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond.

(C) Has commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical-rating organization (NRSRO).

Eligible commercial paper shall have a maximum maturity of 270 days or less. Local agencies, other than counties or a city and county, may invest no more than 25 percent of their money in eligible commercial paper. Local agencies, other than counties or a city and county, may purchase no more than 10 percent of the outstanding commercial paper of any single issuer. Counties or a city and county may invest in commercial paper pursuant to the concentration limits in subdivision (a) of Section 53635.

(h) Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit may not exceed 30 percent of the agency's money which may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposit do not come within Article 2 (commencing with Section 53630), except that the amount so invested shall be subject to the limitations of Section 53638. The legislative body of a local agency and the treasurer or other official of the local agency having legal custody of the money are prohibited from investing local agency funds, or funds in the custody of the local agency, in negotiable certificates of deposit issued by a state or federal credit union if a member of the legislative body of the local agency, or any person with investment decisionmaking authority in the administrative office manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or the supervisory committee of the state or federal credit union issuing the negotiable certificates of deposit.

(i) (1) Investments in repurchase agreements or reverse repurchase agreements or securities lending agreements of any securities authorized by this section, as long as the agreements are subject to this subdivision, including the delivery requirements specified in this section.

(2) Investments in repurchase agreements may be made, on any investment authorized in this section, when the term of the agreement does not exceed one year. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in compliance if the value of the underlying securities is brought back up to 102 percent no later than the next business day.

(3) Reverse repurchase agreements or securities lending agreements may be utilized only when all of the following conditions are met:

(A) The security to be sold on reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the local agency for a minimum of 30 days prior to sale.

(B) The total of all reverse repurchase agreements and securities lending agreements on investments owned by the local agency does not exceed 20 percent of the base value of the portfolio.

(C) The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a

security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(D) Funds obtained or funds within the pool of an equivalent amount to that obtained from selling a security to a counterparty by way of a reverse repurchase agreement or securities lending agreement shall not be used to purchase another security with a maturity longer than 92 days from the initial settlement date of the reverse repurchase agreement or securities lending agreement, unless the reverse repurchase agreement or securities lending agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(4) (A) Investments in reverse repurchase agreements, securities lending agreements, or similar investments in which the local agency sells securities prior to purchase with a simultaneous agreement to repurchase the security may only be made upon prior approval of the governing body of the local agency and shall only be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with a local agency.

(B) For purposes of this chapter, "significant banking relationship" means any of the following activities of a bank:

(i) Involvement in the creation, sale, purchase, or retirement of a local agency's bonds, warrants, notes, or other evidence of indebtedness.

(ii) Financing of a local agency's activities.

(iii) Acceptance of a local agency's securities or funds as deposits.

(5) (A) "Repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the counterparty seller will repurchase the securities on or before a specified date and for a specified amount and the counterparty will deliver the underlying securities to the local agency by book entry, physical delivery, or by third-party custodial agreement. The transfer of underlying securities to the counterparty bank's customer book-entry account may be used for book-entry delivery.

(B) "Securities," for purpose of repurchase under this subdivision, means securities of the same issuer, description, issue date, and maturity.

(C) "Reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase the securities on or before a specified date and includes other comparable agreements.

(D) "Securities lending agreement" means an agreement under which a local agency agrees to transfer securities to a borrower who, in turn, agrees to provide collateral to the local agency. During the term of the agreement, both the securities and the collateral are held by a third party. At the conclusion of the agreement, the securities are transferred back to the local agency in return for the collateral.

(E) For purposes of this section, the base value of the local agency's pool portfolio shall be that dollar amount obtained by totaling all cash balances placed in the pool by all pool participants, excluding any amounts obtained through selling securities by way of reverse repurchase agreements, securities lending agreements, or other similar borrowing methods.

(F) For purposes of this section, the spread is the difference between the cost of funds obtained using the reverse repurchase agreement and the earnings obtained on the reinvestment of the funds.

(j) Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Notes eligible for investment under this subdivision shall be rated "A" or better by a nationally recognized rating service. Purchases of medium-term notes shall not include other instruments authorized by this section and may not exceed 30 percent of the agency's money that may be invested pursuant to this section.

(k) (1) Shares of beneficial interest issued by diversified management companies that invest in the securities and obligations as authorized by subdivisions (a) to (j), inclusive, or subdivisions (m) or (n) and that comply with the investment restrictions of this article and Article 2 (commencing with Section 53630). However, notwithstanding these restrictions, a counterparty to a reverse repurchase agreement or securities lending agreement is not required to be a primary dealer of the Federal Reserve Bank of New York if the company's board of directors finds that the counterparty presents a minimal risk of default, and the value of the securities underlying a repurchase agreement or securities lending agreement may be 100 percent of the sales price if the securities are marked to market daily.

(2) Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.).

(3) If investment is in shares issued pursuant to paragraph (1), the company shall have met either of the following criteria:

(A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations.

(B) Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by subdivisions (a) to (j), inclusive, or subdivisions (m) or (n) and with assets under management in excess of five hundred million dollars (\$500,000,000).

(4) If investment is in shares issued pursuant to paragraph (2), the company shall have met either of the following criteria:

(A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations.

(B) Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management in excess of five hundred million dollars (\$500,000,000).

(5) The purchase price of shares of beneficial interest purchased pursuant to this subdivision shall not include any commission that the companies may charge and shall not exceed 20 percent of the agency's money that may be invested pursuant to this section. However, no more than 10 percent of the agency's funds may be invested in shares of beneficial interest of any one mutual fund pursuant to paragraph (1).

(l) Moneys held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of a local agency, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements, may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness, or lease installment sale, or other agreement, or to the extent not inconsistent therewith or if there are no specific statutory provisions, in accordance

with the ordinance, resolution, indenture, or agreement of the local agency providing for the issuance.

(m) Notes, bonds, or other obligations that are at all times secured by a valid first priority security interest in securities of the types listed by Section 53651 as eligible securities for the purpose of securing local agency deposits having a market value at least equal to that required by Section 53652 for the purpose of securing local agency deposits. The securities serving as collateral shall be placed by delivery or book entry into the custody of a trust company or the trust department of a bank that is not affiliated with the issuer of the secured obligation, and the security interest shall be perfected in accordance with the requirements of the Uniform Commercial Code or federal regulations applicable to the types of securities in which the security interest is granted.

(n) Any mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond of a maximum of five years' maturity. Securities eligible for investment under this subdivision shall be issued by an issuer having an "A" or higher rating for the issuer's debt as provided by a nationally recognized rating service and rated in a rating category of "AA" or its equivalent or better by a nationally recognized rating service. Purchase of securities authorized by this subdivision may not exceed 20 percent of the agency's surplus money that may be invested pursuant to this section.

(o) Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (n), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

(1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.

(2) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (n), inclusive.

(3) The adviser has assets under management in excess of five hundred million dollars (\$500,000,000).

53601.1. The authority of a local agency to invest funds pursuant to Section 53601 includes, in addition thereto, authority to invest in financial futures or financial option contracts in any of the investment categories enumerated in that section.

53601.2. As used in this article, "corporation" includes a limited liability company.

53601.5. The purchase by a local agency of any investment authorized pursuant to Section 53601 or 53601.1, not purchased directly from the issuer, shall be purchased either from an institution licensed by the state as a broker-dealer, as defined in Section 25004 of the Corporations Code, or from a member of a federally regulated securities exchange, from a national or state-chartered bank, from a savings association or federal association (as defined by Section 5102 of the Financial Code) or from a brokerage firm designated as a primary government dealer by the Federal Reserve bank.

53601.6. (a) A local agency shall not invest any funds pursuant to this article or pursuant to Article 2 (commencing with Section 53630) in inverse floaters, range notes, or mortgage-derived, interest-only strips.

(b) A local agency shall not invest any funds pursuant to this article or pursuant to Article 2 (commencing with Section 53630) in any security that could result in zero interest accrual if held to maturity. However, a local agency may hold prohibited instruments until their maturity dates. The limitation in this subdivision shall not apply to local agency investments in shares of beneficial interest issued by diversified management companies registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.) that are authorized for investment pursuant to subdivision (k) of Section 53601.

53601.7. Notwithstanding the investment parameters of Sections 53601 and 53635, a local agency that is a county or a city and county may invest any portion of the funds that it deems wise or expedient, using the following criteria:

(a) No investment shall be made in any security, other than a security underlying a repurchase agreement, reverse repurchase agreement, or a securities lending agreement, that, at the time of purchase, has a term remaining to maturity in excess of 397 days, and that would cause the dollar-weighted average maturity of the funds in the investment pool to exceed 90 days.

(b) All corporate and depository institution investments shall meet or exceed the following credit rating criteria at time of purchase:

(1) Short-term debt shall be rated at least "A-1" by Standard & Poor's Corporation, "P-1" by Moody's Investors Service, Inc., or "F-1" by Fitch Ratings. If the issuer of short-term debt has also issued long-term debt, this long-term debt rating shall be rated at least "A," without regard to +/- or 1, 2, 3 modifiers, by Standard & Poor's Corporation, Moody's Investors Service, Inc., or Fitch Ratings.

(2) Long-term debt shall be rated at least "A," without regard to +/- or 1, 2, 3 modifiers, by Standard & Poor's Corporation, Moody's Investors Service, Inc., or Fitch Ratings.

(c) (1) No more than 5 percent of the total assets of the investments held by a local agency may be invested in the securities of any one issuer, except the obligations of the United States government, United States government agencies, and United States government-sponsored enterprises.

(2) Up to 25 percent of the total assets of the investments held by a local agency may be invested in the first tier securities of a single issuer for a period of up to three business days after acquisition. The securities of no more than one issuer may be invested pursuant to this paragraph at a time.

(3) No more than 10 percent of the total assets of the investments held by a local agency may be invested in any one mutual fund.

(d) Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. A later increase or decrease in a percentage resulting from a change in values or assets shall not constitute a violation of that restriction. If subsequent to purchase, securities are downgraded below the minimum acceptable rating level, the securities shall be reviewed for possible sale within a reasonable amount of time after the downgrade.

(e) Within the limitations set forth in this section, a local agency electing to invest its funds pursuant to this section may invest in the following securities:

(1) Direct obligations of the United States Treasury or any other obligation guaranteed as to principal and interest by the United States government.

(2) Bonds, notes, debentures, or any other obligations of, or securities issued by, any federal government agency, instrumentality, or government-sponsored enterprise.

(3) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or other entity of the state.

(4) Bonds, notes, warrants, or other indebtedness of the local agency, or any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

(5) Bankers acceptance, otherwise known as bills of exchange or time drafts drawn on and accepted by a commercial bank, primarily used to finance international trade. Purchases of bankers acceptances may not exceed 180 days to maturity.

(6) Short-term unsecured promissory notes issued by corporations for maturities of 270 days or less. Eligible commercial paper is further limited to the following:

(A) Issuing corporations that are organized and operating within the United States, having total assets in excess of five hundred million dollars (\$500,000,000).

(B) Maturities for eligible commercial paper that may not exceed 270 days.

(7) A certificate representing a deposit of funds at a commercial bank for a specified period of time and for a specified return at maturity. Eligible certificates of deposit shall be issued by a nationally or state-chartered bank or a state or federal association, as defined in Section 5102 of the Financial Code, or by a state-licensed branch of a foreign bank. For purposes of this subdivision, certificates of deposits shall not come within Article 2 (commencing with Section 53630), except that the amount so invested shall be subject to the limitations of Section 53638. The legislative body of a local agency and the treasurer or other official of the local agency having legal custody of the money may not invest local agency funds, or funds in the custody of the local agency, in negotiable certificates of deposit issued by a state or federal credit union if a member of the legislative body of the local agency, or any person with investment decisionmaking authority in the administrative office, manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency also serves on the board of directors, or any committee appointed by the board of directors, other credit committee or the supervisory committee of the state or federal credit union issuing the negotiable certificate of deposit.

(8) Repurchase agreements, reverse repurchase agreements, or securities lending agreements of any securities authorized by this section, if the agreements meet the requirements of this paragraph and the delivery requirements specified in Section 53601. Investments in repurchase agreements may be made, on any investment authorized by this section, when the term of the agreement does not exceed one year. The market value of the securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities, and the value shall be adjusted no less than quarterly. Because the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in compliance with this section if the value of the underlying securities is brought back to 102 percent no later than the next business day. Reverse repurchase agreements may be utilized only when all of the following criteria are met:

(A) The security being sold on reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the local agency for a minimum of 30 days prior to the sale.

(B) The total of all reverse repurchase agreements on investments owned by the local agency not purchased or committed to purchase does not exceed 20 percent of the market value of the portfolio.

(C) The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement and the final maturity date of the same security.

(D) Funds obtained or funds within the pool of an equivalent amount to that obtained from selling a security to a counterparty by way of a reverse repurchase agreement or securities lending agreement, may not be used to purchase another security with a maturity longer than 92 days from the initial settlement date of the reverse repurchase agreement or securities lending agreement, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

(E) Investments in reverse repurchase agreements or similar investments in which the local agency sells securities prior to purchase with a simultaneous agreement to repurchase the security, shall only be made with prior approval of the governing body of the local agency and shall only be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with a local agency.

"Securities," for purposes of this paragraph, means securities of the same issuer, description, issue date, and maturity.

(9) All debt securities issued by a corporation or depository institution with a remaining maturity of not more than 397 days, including securities specified as "medium-term notes," as well as other debt instruments originally issued with maturities longer than 397 days, but which, at time of purchase, have a final maturity of 397 days or less. Eligible medium-term notes shall be issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States.

(10) (A) Shares of beneficial interest issued by diversified management companies that invest in the securities and obligations described in this subdivision and that comply with the investment restrictions of this section. However, notwithstanding these restrictions, a counterparty to a reverse repurchase agreement shall not be required to be a primary dealer of the Federal Reserve Bank of New York if the company's board of directors finds that the counterparty presents a minimal risk of default. The value of the securities underlying a repurchase agreement may be 100 percent of the sales price if the securities are marked to market daily.

(B) Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the federal Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.).

(C) All shares of beneficial interest described in this paragraph shall have met either of the following criteria:

(i) Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations.

(ii) Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission and who has not less than five years' experience investing in money market instruments and with assets under management in excess of five hundred million dollars (\$500,000,000).

(11) Any mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other paythrough bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond.

Securities eligible for investment under this paragraph shall be issued by an issuer having an "A" or higher rating from the issuer's debt as provided by a nationally recognized rating service and rated in a rating category of "AA" or its equivalent or better by a nationally recognized rating.

(12) Contracts issued by insurance companies that provide the policyholder with the right to receive a fixed or variable rate of interest and the full return of principal at the maturity date.

(13) Any investments that would qualify under SEC Rule 2a-7 of the Investment Company Act of 1940 guidelines. These investments shall also meet the limitations detailed in this section.

(f) For purposes of this section, all of the following definitions shall apply:

(1) "Repurchase agreement" means a purchase of securities pursuant to an agreement by which the counterparty seller will repurchase the securities on or before a specified date and for a specified amount and the counterparty will deliver the underlying securities to the local agency by book entry, physical delivery, or by third-party custodial agreement.

(2) "Significant banking relationship" means any of the following activities of a bank:

(A) Involvement in the creation, sale, purchase, or retirement of a local agency's bonds, warrants, notes, or other evidence of indebtedness.

(B) Financing of a local agency's securities or funds as deposits.

(C) Acceptance of a local agency's securities or funds as deposits.

(3) "Reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase the securities on or before a specified date and includes other comparable agreements.

(4) "Securities lending agreement" means an agreement with a local agency that agrees to transfer securities to a borrower who, in turn agrees to provide collateral to the local agency. During the term of the agreement, both the securities and the collateral are held by a third party. At the conclusion of the agreement, the securities are transferred back to the local agency in return for the collateral.

(5) "First tier security" has the same meaning as that phrase is defined by SEC Rule 2a-7 of the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq).

(6) "Local agency" means a county or city and county.

(g) For purposes of this section, the base value of the local agency's pool portfolio shall be that dollar amount obtained by totaling all cash balances placed in the pool by all pool participants, excluding any amounts obtained through selling securities by way of reverse repurchase agreements, or other similar borrowing methods.

(h) For purposes of this section, the spread is the difference between the cost of funds obtained using the reverse repurchase agreement and the earnings obtained on the reinvestment of the funds.

(i) This section shall remain in effect only until January 1, 2011, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2011, deletes or extends that date.

53601.8. Notwithstanding Section 53601 or any other provision of this code, a local agency, at its discretion, may invest a portion of its surplus funds in certificates of deposit at a commercial bank, savings bank, savings and loan association, or credit union that uses a private sector entity that assists in the placement of certificates of deposit, provided that the purchases of certificates of deposit pursuant to this section, Section 53635.8, and subdivision (h) of Section 53601 do not, in total, exceed 30 percent of the agency's funds that may be invested for this purpose. The following conditions shall apply:

(a) The local agency shall choose a nationally or state chartered commercial bank, savings bank, savings and loan association, or credit union in this state to invest the funds, which shall be known as the "selected" depository institution.

(b) The selected depository institution may submit the funds to a private sector entity that assists in the placement of certificates of deposit with one or more commercial banks, savings banks, savings and loan associations, or credit unions that are located in the United States, for the local agency's account.

(c) The full amount of the principal and the interest that may be accrued during the maximum term of each certificate of deposit shall at all times be insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

(d) The selected depository institution shall serve as a custodian for each certificate of deposit that is issued with the placement service for the local agency's account.

(e) At the same time the local agency's funds are deposited and the certificates of deposit are issued, the selected depository institution shall receive an amount of deposits from other commercial banks, savings banks, savings and loan associations, or credit unions that, in total, are equal to, or greater than, the full amount of the principal that the local agency initially deposited through the selected depository institution for investment.

(f) A local agency may not invest surplus funds with a selected depository institution for placement as certificates of deposit pursuant to this section on or after January 1, 2012. A local agency's surplus funds, invested pursuant to this section before January 1, 2012, may remain invested in certificates of deposit issued through a private sector entity for the full term of each certificate of deposit.

(g) Notwithstanding subdivisions (a) to (f), inclusive, no credit union may act as a selected depository institution under this section or Section 53635.8 unless both of the following conditions are satisfied:

(1) The credit union offers federal depository insurance through the National Credit Union Administration.

(2) The credit union is in possession of written guidance or other written communication from the National Credit Union Administration authorizing participation of federally-insured credit unions in one or more certificate of deposit placement services and affirming that the moneys held by those credit unions while participating in a deposit placement service will at all times be insured by the federal government.

(h) It is the intent of the Legislature that nothing in this section shall restrict competition among private sector entities that provide placement services pursuant to this section.

53602. The legislative body shall invest only in notes, bonds, bills, certificates of indebtedness, warrants, or registered warrants which are legal investments for savings banks in the State, provided, that the board of supervisors of a county may, by a four-fifths vote thereof, invest in notes, warrants or other evidences of indebtedness of public districts wholly or partly within the

county, whether or not such notes, warrants, or other evidences of indebtedness are legal investments for savings banks.

53603. The legislative body may make the investment by direct purchase of any issue of eligible securities at their original sale or after they have been issued.

53604. The legislative body may sell, or exchange for other eligible securities, and reinvest the proceeds of, the securities purchased.

53605. From time to time, the legislative body shall sell the securities so that the proceeds may be applied to the purposes for which the original purchase money was placed in the sinking fund or the treasury of the local agency.

53606. The bonds purchased, which were issued by the purchaser, may be canceled either in satisfaction or sinking fund obligations or otherwise. When canceled, they are no longer outstanding, unless in its discretion, the legislative body holds them uncanceled. While held uncanceled, the bonds may be resold.

53607. The authority of the legislative body to invest or to reinvest funds of a local agency, or to sell or exchange securities so purchased, may be delegated for a one-year period by the legislative body to the treasurer of the local agency, who shall thereafter assume full responsibility for those transactions until the delegation of authority is revoked or expires, and shall make a monthly report of those transactions to the legislative body. Subject to review, the legislative body may renew the delegation of authority pursuant to this section each year.

53608. The legislative body of a local agency may deposit for safekeeping with a federal or state association (as defined by Section 5102 of the Financial Code), a trust company or a state or national bank located within this state or with the Federal Reserve Bank of San Francisco or any branch thereof within this state, or with any Federal Reserve bank or with any state or national bank located in any city designated as a reserve city by the Board of Governors of the Federal Reserve System, the bonds, notes, bills, debentures, obligations, certificates of indebtedness, warrants, or other evidences of indebtedness in which the money of the local agency is invested pursuant to this article or pursuant to other legislative authority. The local agency shall take from such financial institution a receipt for securities so deposited. The authority of the legislative body to deposit for safekeeping may be delegated by the legislative body to the treasurer of the local agency; the treasurer shall not be responsible for securities delivered to and receipted for by a financial institution until they are withdrawn from the financial institution by the treasurer.

53609. Notwithstanding the provisions of this chapter or any other provisions of this code, funds held by a local agency pursuant to a written agreement between the agency and employees of the agency to defer a portion of the compensation otherwise receivable by the agency's employees and pursuant to a plan for such deferral as adopted by the governing body of the agency, may be invested in the types of investments set forth in Sections 53601 and 53602 of this code, and may additionally be invested in corporate stocks, bonds, and securities, mutual funds, savings and loan accounts, credit union accounts, life insurance policies, annuities, mortgages, deeds of trust, or other security interests in real or personal property. Nothing herein shall be construed to permit any type of investment prohibited by the Constitution.

Deferred compensation funds are public pension or retirement funds for the purposes of Section 17 of Article XVI of the Constitution.

## **GOVERNMENT CODE**

### **SECTION 53630-53686**

53630. As used in this article:

(a) "Local agency" means county, city, city and county, including a chartered city or county, a community college district, or other public agency or corporation in this state.

(b) "Treasurer" means treasurer of the local agency.

(c) "Depository" means a state or national bank, savings association or federal association, a state or federal credit union, or a federally insured industrial loan company, in this state in which the moneys of a local agency are deposited.

(d) "Agent of depository" means a trust company or trust department of a state or national bank located in this state, including the trust department of a depository where authorized, and the Federal Home Loan Bank of San Francisco, which is authorized to act as an agent of depository for the purposes of this article pursuant to Section 53657.

(e) "Security" means any of the eligible securities or obligations listed in Section 53651.

(f) "Pooled securities" means eligible securities held by an agent of depository for a depository and securing deposits of one or more local agencies.

(g) "Administrator" means the Administrator of Local Agency Security of the State of California.

(h) "Savings association or federal association" means a savings association, savings and loan association, or savings bank as defined by Section 5102 of the Financial Code.

(i) "Federally insured industrial loan company" means an industrial loan company licensed under Division 7 (commencing with Section 18000) of the Financial Code, the investment certificates of which are insured by the Federal Deposit Insurance Corporation.

(j) "Corporation" includes a limited liability company.

53630.1. The Legislature hereby finds that the solvency and creditworthiness of each individual local agency can impact the solvency and creditworthiness of the state and other local agencies within the state. Therefore, to protect the solvency and creditworthiness of the state and all of its political subdivisions, the Legislature hereby declares that the deposit and investment of public funds by local officials and local agencies is an issue of statewide concern.

53630.5. (a) The definitions in Section 1700 of, and Chapter 1 (commencing with Section 99) of Division 1 of, the Financial Code apply to this section.

(b) In this article, for purposes of being a depository of moneys belonging to or being in the custody of a local agency, the phrases "state or national bank located in this state," "state or national bank," "state or national bank in this state," and "state or national banks in the state" include, without limitation, any of the following:

(1) Any California branch office of a foreign (other state) state bank that the bank is authorized to maintain under the law of its domicile and federal law.

(2) Any California branch office of a foreign (other state) national bank that the bank is authorized to maintain under federal law.

(3) Any California branch office of a foreign (other nation) bank that the bank is licensed to maintain under Article 3 (commencing with Section 1750) of Chapter 13.5 of Division 1 of the Financial Code.

(4) Any California federal branch of a foreign (other nation) bank that the bank is authorized to maintain under federal law.

53631. Under those conditions as the treasurer of a local agency fixes with the approval of the legislative body, he or she may establish accounts at banks within or without the state and deposit money in those accounts to the extent necessary to pay the principal and interest of bonds to pay any warrant that has been presented for payment, or to fund any electronic disbursement of funds from the treasury of the local agency. This article does not apply to deposits for those purposes.

53632. There are three classes of deposits:

- (a) Inactive deposits.
- (b) Active deposits.
- (c) Interest-bearing active deposits.

53632.5. There are three classes of security for deposits:

- (a) Securities described in subdivision (m) of Section 53651.
- (b) Securities described in subdivision (p) of Section 53651.
- (c) Securities enumerated in Section 53651, except for those described in subdivisions (m) and (p) of that section.

53633. The treasurer shall determine the amounts of money to be deposited as inactive, active, and interest-bearing active deposits, except as otherwise provided in Section 53679.

53634. The treasurer may call in money from inactive deposits and place it in active deposits as current demands require. When there is money in his possession for which there is no demand as inactive deposits, he may place it as active deposits.

53635. (a) This section shall apply to a local agency that is a county, a city and a county, or other local agency that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body. However, Section 53601 shall apply to all local agencies that pool money in deposits or investments exclusively with local agencies that have the same governing body.

This section shall be interpreted in a manner that recognizes the distinct characteristics of investment pools and the distinct administrative burdens on managing and investing funds on a pooled basis pursuant to Article 6 (commencing with Section 27130) of Chapter 5 of Division 2 of Title 3.

A local agency that is a county, a city and county, or other local agency that pools money in deposits or investments with other agencies may invest in commercial paper pursuant to subdivision (g) of Section 53601, except that the local agency shall be subject to the following concentration limits:

- (1) No more than 40 percent of the local agency's money may be invested in eligible commercial paper.
- (2) No more than 10 percent of the total assets of the investments held by a local agency may be invested in any one issuer's commercial paper.

(b) Notwithstanding Section 53601, the City of Los Angeles shall be subject to the concentration limits of this section for counties and for cities and counties with regard to the investment of money in eligible commercial paper.

53635.2. As far as possible, all money belonging to, or in the custody of, a local agency, including money paid to the treasurer or other official to pay the principal, interest, or penalties of bonds, shall be deposited for safekeeping in state or national banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies in this state selected by the treasurer or other official having legal custody of the money; or may be invested in the investments set forth in Section 53601. To be eligible to receive local agency money, a bank, savings association, federal association, or federally insured industrial loan company shall have received an overall rating of not less than "satisfactory" in its most recent evaluation by the appropriate federal financial supervisory agency of its record of meeting the credit needs of California's communities, including low- and moderate-income neighborhoods, pursuant to Section 2906 of Title 12 of the United States Code. Sections 53601.5 and 53601.6 shall apply to all investments that are acquired pursuant to this section.

53635.7. In making any decision that involves borrowing in the amount of one hundred thousand dollars (\$100,000) or more, the legislative body of the local agency shall discuss, consider, and deliberate each decision as a separate item of business on the agenda of its meeting as prescribed in Chapter 9 (commencing with Section 54950). As used in this section, "borrowing" does not include bank overdrafts or security lending.

53635.8. Notwithstanding Section 53601 or any other provision of this code, a local agency, at its discretion, may invest a portion of its surplus funds in certificates of deposit at a commercial bank, savings bank, savings and loan association, or credit union that uses a private sector entity that assists in the placement of certificates of deposit, provided that the purchases of certificates of deposit pursuant to this section, Section 53601.8, and subdivision (h) of Section 53601 do not, in total, exceed 30 percent of the agency's funds that may be invested for this purpose. The following conditions shall apply:

(a) The local agency shall choose a nationally or state chartered commercial bank, savings bank, savings and loan association, or credit union in this state to invest the funds, which shall be known as the "selected" depository institution.

(b) The selected depository institution may submit the funds to a private sector entity that assists in the placement of certificates of deposit with one or more commercial banks, savings banks (savings and loan associations), or credit unions that are located in the United States, for the local agency's account.

(c) The full amount of the principal and the interest that may be accrued during the maximum term of each certificate of deposit shall at all times be insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

(d) The selected depository institution shall serve as a custodian for each certificate of deposit that is issued with the placement service for the local agency's account.

(e) At the same time the local agency's funds are deposited and the certificates of deposit are issued, the selected depository institution shall receive an amount of deposits from other commercial banks, savings banks, savings and loan associations, or credit unions that, in total,

are equal to, or greater than, the full amount of the principal that the local agency initially deposited through the selected depository institution for investment.

(f) A local agency may not invest surplus funds with a selected depository institution for placement as certificates of deposit pursuant to this section on or after January 1, 2012. A local agency's surplus funds, invested pursuant to this section before January 1, 2012, may remain invested in certificates of deposit issued through a private sector entity for the full term of each certificate of deposit.

(g) Notwithstanding subdivisions (a) to (f), inclusive, no credit union may act as a selected depository institution under this section or Section 53601.8 unless both of the following conditions are satisfied:

(1) The credit union offers federal depository insurance through the National Credit Union Administration.

(2) The credit union is in possession of written guidance or other written communication from the National Credit Union Administration authorizing participation of federally-insured credit unions in one or more certificate of deposit placement services and affirming that the moneys held by those credit unions while participating in a deposit placement service will at all times be insured by the federal government.

(h) It is the intent of the Legislature that nothing in this section shall restrict competition among private sector entities that provide placement services pursuant to this section.

53636. Money so deposited is deemed to be in the treasury of the local agency.

53637. The money shall be deposited in any bank, savings association or federal association, state or federal credit union, or federally insured industrial loan company with the objective of realizing maximum return, consistent with prudent financial management, except that money shall not be deposited in any state or federal credit union if a member of the legislative body of a local agency, or any person with investment decisionmaking authority of the administrative office, manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency, also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or supervisory committee, of the state or federal credit union.

53638. (a) The deposit shall not exceed the shareholder's equity of any depository bank. For the purposes of this subdivision, shareholder's equity shall be determined in accordance with Section 118 of the Financial Code, but shall be deemed to include capital notes and debentures.

(b) The deposit shall not exceed the total of the net worth of any depository savings association or federal association, except that deposits not exceeding a total of five hundred thousand dollars (\$500,000) may be made to a savings association or federal association without regard to the net worth of that depository, if such deposits are insured or secured as required by law.

(c) The deposit to the share accounts of any regularly chartered credit union shall not exceed the total of the unimpaired capital and surplus of the credit union, as defined by rule of the Commissioner of Financial Institutions, except that the deposit to any credit union share account in an amount not exceeding five hundred thousand dollars (\$500,000) may be made if the share accounts of that credit union are insured or guaranteed pursuant to Section 14858 of the Financial Code or are secured as required by law.

(d) The deposit in investment certificates of a federally insured industrial loan company shall not exceed the total of the unimpaired capital and surplus of the insured industrial loan company.

53639. Except as otherwise provided in Section 53682, the depository shall bear the expenses of transportation of money to and from the depository.

53640. Except as otherwise provided in Section 53682, the depository shall handle, collect, and pay all checks, drafts, and other exchange without cost to the local agency.

53641. When money is deposited in a depository, the treasurer or other authorized official shall take and preserve a receipt, certificate of deposit, or other evidence of the deposit as he or she requires.

53642. The money deposited may be drawn out by check or order of the treasurer or other official authorized to make such deposit.

53643. The treasurer may deposit any part of the money as agreed upon between the treasurer and the depository.

53644. If an agreement is not made:

(a) Active deposits and interest thereon are subject to withdrawal upon the demand of the treasurer or other authorized official, subject to any penalties which may be prescribed by federal law or regulation.

(b) Inactive deposits are subject to notice of at least thirty days before withdrawal.

53645. Interest shall be computed and paid by the depository, as follows:

(a) For active deposits upon which interest is payable, interest shall be computed on the average daily balance for the calendar quarter, and shall be paid quarterly.

(b) For inactive deposits, interest shall be computed on a 360-day basis, and shall be paid quarterly.

53646. (a) (1) In the case of county government, the treasurer may annually render to the board of supervisors and any oversight committee a statement of investment policy, which the board shall review and approve at a public meeting. Any change in the policy shall also be reviewed and approved by the board at a public meeting.

(2) In the case of any other local agency, the treasurer or chief fiscal officer of the local agency may annually render to the legislative body of that local agency and any oversight committee of that local agency a statement of investment policy, which the legislative body of the local agency shall consider at a public meeting. Any change in the policy shall also be considered by the legislative body of the local agency at a public meeting.

(b) (1) The treasurer or chief fiscal officer may render a quarterly report to the chief executive officer, the internal auditor, and the legislative body of the local agency. The quarterly report shall be so submitted within 30 days following the end of the quarter covered by the report. Except as provided in subdivisions (e) and (f), this report shall include the type of investment, issuer, date of maturity par and dollar amount invested on all securities, investments and moneys held by the local agency, and shall additionally include a description of any of the local agency's funds, investments, or programs, that are under the management of contracted parties, including lending programs. With respect to all securities held by the local agency, and under management

of any outside party that is not also a local agency or the State of California Local Agency Investment Fund, the report shall also include a current market value as of the date of the report, and shall include the source of this same valuation.

(2) The quarterly report shall state compliance of the portfolio to the statement of investment policy, or manner in which the portfolio is not in compliance.

(3) The quarterly report shall include a statement denoting the ability of the local agency to meet its pool's expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.

(4) In the quarterly report, a subsidiary ledger of investments may be used in accordance with accepted accounting practices.

(c) Pursuant to subdivision (b), the treasurer or chief fiscal officer shall report whatever additional information or data may be required by the legislative body of the local agency.

(d) The legislative body of a local agency may elect to require the report specified in subdivision (b) to be made on a monthly basis instead of quarterly.

(e) For local agency investments that have been placed in the Local Agency Investment Fund, created by Section 16429.1, in National Credit Union Share Insurance Fund-insured accounts in a credit union, in accounts insured or guaranteed pursuant to Section 14858 of the Financial Code, or in Federal Deposit Insurance Corporation-insured accounts in a bank or savings and loan association, in a county investment pool, or any combination of these, the treasurer or chief fiscal officer may supply to the governing body, chief executive officer, and the auditor of the local agency the most recent statement or statements received by the local agency from these institutions in lieu of the information required by paragraph (1) of subdivision (b) regarding investments in these institutions.

(f) The treasurer or chief fiscal officer shall not be required to render a quarterly report, as required by subdivision (b), to a legislative body or any oversight committee of a school district or county office of education for securities, investments, or moneys held by the school district or county office of education in individual accounts that are less than twenty-five thousand dollars (\$25,000).

(g) A city shall not be required to submit a quarterly report to the commission if, during the entire reporting period, the city has maintained 100 percent of its investment portfolio in (1) the treasury of the county in which it is located for investment by the county treasurer pursuant to Section 53684, (2) the Local Agency Investment Fund created by Section 16429.1, (3) National Credit Union Share Insurance Fund-insured accounts in a credit union, in accounts insured or guaranteed pursuant to Section 14858 of the Financial Code, or in Federal Deposit Insurance Corporation-insured accounts in a bank or savings and loan association, or (4) in any combination of these.

(h) A county or city and county shall not be required to submit a quarterly report to the commission if, during the entire reporting period, the county has maintained 100 percent of its investment portfolio in (1) the Local Agency Investment Fund created by Section 16429.1, (2) National Credit Union Share Insurance Fund-insured accounts in a credit union, in accounts insured or guaranteed pursuant to Section 14858 of the Financial Code, or in Federal Deposit Insurance Corporation-insured accounts in a bank or savings and loan association, or (3) in any combination of these.

(i) The city, county, or city and county investor of any public funds, no later than 60 days after the close of the second quarter of each calendar year and 60 days after the subsequent

amendments thereto, shall provide the statement of investment policy required pursuant to this section, to the California Debt and Investment Advisory Commission.

(j) In recognition of the state and local interests served by the actions made optional in subdivisions (a) and (b), the Legislature encourages the local agency officials to continue taking the actions formerly mandated by this section. However, nothing in this subdivision may be construed to impose any liability on a local agency that does not continue to take the formerly mandated action.

53647. (a) Interest on all money deposited belongs to, and shall be paid quarterly into the general fund of, the local agency represented by the officer making the deposit, unless otherwise directed by law.

(b) Notwithstanding the provisions of subdivision (a), and except as otherwise directed by law, if the governing body of the local agency represented by the officer making the deposit so directs, such interest shall be paid to the fund which contains the principal on which the interest accrued.

53647.5. Notwithstanding any other provision of law, interest earned on any bail money deposited in a bank account pursuant to Section 1463.1 of the Penal Code and Section 53679 of this code shall, if the board of supervisors so directs, be allocated for the support of the courts in that county.

53648. Notwithstanding this article, the treasurer may deposit moneys in, and enter into contracts with, a state or national bank, savings association or federal association, federal or state credit union, or federally insured industrial loan company, pursuant to a federal law or a rule of a federal department or agency adopted pursuant to the law if the law or rule conflicts with this article in regulating the payment of interest on deposits of public moneys by any of the following:

(a) Banks which are Federal Reserve System members or whose deposits are insured by the Federal Deposit Insurance Corporation.

(b) Savings associations or federal associations which are federal home loan bank members or whose deposits are insured by the Federal Savings and Loan Insurance Corporation.

(c) State or federal credit unions whose accounts are insured by the National Credit Union Share Insurance Fund or guaranteed by the California Credit Union Share Guaranty Corporation or insured or guaranteed pursuant to Section 14858 of the Financial Code, unless a member of the legislative body of a local agency, or any person with investment decisionmaking authority of the administrative office, manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency, also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or supervisory committee, of the state or federal credit union.

(d) A federally insured industrial loan company.

53648.5. Upon the removal by federal law of the conflicting federal law or rule the agreement between the treasurer or other authorized official and a depository may be terminated by either party.

53649. The treasurer is responsible for the safekeeping of money in his or her custody and shall enter into any contract with a depository relating to any deposit which in his or her judgment is to the public advantage. The depository, and the agent of depository to the extent the agent of depository has been notified of deposits and the amount thereof, are responsible for securing moneys deposited pursuant to such a contract in accordance with Section 53652. One copy of each contract shall be filed with the auditor, controller, secretary, or corresponding officer of the local agency. The contract shall:

- (a) Fix the duration of deposits, if appropriate.
- (b) Fix the interest rate, if any.
- (c) Provide conditions for withdrawal and repayment.
- (d) Provide for placement of pooled securities in a named agent of depository in accordance with Section 53656.
- (e) Grant authority for agent of depository to place securities for safekeeping in accordance with Section 53659.
- (f) Set forth in accordance with Section 53665 the conditions upon which the administrator shall order pooled securities converted into money for the benefit of the local agency, and the procedure therefor.
- (g) Provide for compliance in all respects with the provisions of this article and other applicable provisions of law.
- (h) Provide, upon notice to the treasurer from the administrator, that a treasurer may withdraw deposits in the event a depository fails to pay the assessments, fines, or penalties assessed by the administrator or may withdraw authorization for the placement of pooled securities in an agent of depository in the event that the agent of depository fails to pay the fines or penalties assessed by the administrator.

53651. Eligible securities are any of the following:

- (a) United States Treasury notes, bonds, bills or certificates of indebtedness, or obligations for which the faith and credit of the United States are pledged for the payment of principal and interest, including the guaranteed portions of small business administration loans, so long as the loans are obligations for which the faith and credit of the United States are pledged for the payment of principal and interest.
- (b) Notes or bonds or any obligations of a local public agency (as defined in the United States Housing Act of 1949) or any obligations of a public housing agency (as defined in the United States Housing Act of 1937) for which the faith and credit of the United States are pledged for the payment of principal and interest.
- (c) Bonds of this state or of any local agency or district of the State of California having the power, without limit as to rate or amount, to levy taxes or assessments to pay the principal and interest of the bonds upon all property within its boundaries subject to taxation or assessment by the local agency or district, and in addition, limited obligation bonds pursuant to Article 4 (commencing with Section 50665) of Chapter 3 of Division 1, senior obligation bonds pursuant to Article 5 (commencing with Section 53387) of Chapter 2.7, and revenue bonds and other obligations payable solely out of the revenues from a revenue-producing property owned, controlled or operated by the state, local agency or district or by a department, board, agency or authority thereof.
- (d) Bonds of any public housing agency (as defined in the United States Housing Act of 1937, as amended) as are secured by a pledge of annual contributions under an annual contribution

contract between the public housing agency and the Public Housing Administration if such contract shall contain the covenant by the Public Housing Administration which is authorized by subsection (b) of Section 22 of the United States Housing Act of 1937, as amended, and if the maximum sum and the maximum period specified in the contract pursuant to that subsection 22(b) shall not be less than the annual amount and the period for payment which are requisite to provide for the payment when due of all installments of principal and interest on the obligations.

(e) Registered warrants of this state.

(f) Bonds, consolidated bonds, collateral trust debentures, consolidated debentures, or other obligations issued by the United States Postal Service, federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, consolidated obligations of the federal home loan banks established under the Federal Home Loan Bank Act, bonds, debentures and other obligations of the Federal National Mortgage Association or of the Government National Mortgage Association established under the National Housing Act, as amended, bonds of any federal home loan bank established under that act, bonds, debentures and other obligations of the Federal Home Loan Mortgage Corporation established under the Emergency Home Finance Act of 1970, and obligations of the Tennessee Valley Authority.

(g) Notes, tax anticipation warrants or other evidence of indebtedness issued pursuant to Article 7 (commencing with Section 53820), Article 7.5 (commencing with Section 53840) or Article 7.6 (commencing with Section 53850) of this Chapter 4.

(h) State of California notes.

(i) Bonds, notes, certificates of indebtedness, warrants or other obligations issued by: (1) any state of the United States (except this state), or the Commonwealth of Puerto Rico, or any local agency thereof having the power to levy taxes, without limit as to rate or amount, to pay the principal and interest of such obligations, or (2) any state of the United States (except this state), or the Commonwealth of Puerto Rico, or a department, board, agency or authority thereof except bonds which provide for or are issued pursuant to a law which may contemplate a subsequent legislative appropriation as an assurance of the continued operation and solvency of the department, board, agency or authority but which does not constitute a valid and binding obligation for which the full faith and credit of such state or the Commonwealth of Puerto Rico are pledged, which are payable solely out of the revenues from a revenue-producing source owned, controlled or operated thereby; provided the obligations issued by an entity described in (1), above, are rated in one of the three highest grades, and such obligations issued by an entity described in (2), above, are rated in one of the two highest grades by a nationally recognized investment service organization that has been engaged regularly in rating state and municipal issues for a period of not less than five years.

(j) Obligations issued, assumed or guaranteed by the International Bank for Reconstruction and Development, Inter-American Development Bank, the Government Development Bank of Puerto Rico, the Asian Development Bank, the International Finance Corporation, or the African Development Bank.

(k) Participation certificates of the Export-Import Bank of the United States.

(l) Bonds and notes of the California Housing Finance Agency issued pursuant to Chapter 7 (commencing with Section 51350) of Part 3 of Division 31 of the Health and Safety Code.

(m) Promissory notes secured by first mortgages and first trust deeds which comply with Section 53651.2.

(n) Any bonds, notes, warrants, or other evidences of indebtedness of a nonprofit corporation issued to finance the construction of a school building or school buildings pursuant to a lease or agreement with a school district entered into in compliance with the provisions of Section 39315 or 81345 of the Education Code, and also any bonds, notes, warrants or other evidences of indebtedness issued to refinance those bonds, notes, warrants, or other evidences of indebtedness as specified in Section 39317 of the Education Code.

(o) Any municipal securities, as defined by Section 3(a)(29) of the Securities Exchange Act of June 6, 1934, (15 U.S.C. Sec. 78, as amended), which are issued by this state or any local agency thereof.

(p) With the consent of the treasurer, letters of credit issued by the Federal Home Loan Bank of San Francisco which comply with Section 53651.6.

53651.2. (a) To be an eligible security under subdivision (m) of Section 53651, a promissory note placed in a securities pool on or after January 1, 1987, shall comply with all of the following provisions:

(1) Each promissory note shall be secured by a first mortgage or first trust deed on improved 1 to 4 unit residential real property located in California, shall be fully amortized over the term of the note, and shall have a term of no more than 30 years. Any first mortgage or first trust deed which secures a promissory note providing for negative amortization shall be removed from the securities pool and replaced with an eligible security under subdivision (m) of Section 53651 if the loan to value ratio exceeds 85 percent of the original appraised value of the security property as a consequence of negative amortization.

(2) Each promissory note shall be eligible for sale to the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation; provided, however, that up to 25 percent of the total dollar amount of any promissory note securities pool established pursuant to Section 53658 may consist of promissory notes with loan amounts which exceed the maximum amounts eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, but which do not exceed: (i) five hundred thousand dollars (\$500,000) in the case of a single family dwelling; (ii) one million dollars (\$1,000,000) in the case of a 2, 3, or 4 unit dwelling.

(b) The following shall not constitute eligible securities under subdivision (m) of Section 53651:

(1) Any promissory note on which any payment is more than 60 days past due.

(2) Any promissory note secured by a mortgage or deed of trust as to which there is a lien prior to the mortgage or deed of trust. For the purposes of this paragraph, no lien specified in Section 766 of the Financial Code shall be considered a prior encumbrance unless any installment or payment thereunder (other than a rental or royalty under a lease) is due and delinquent.

(3) Any promissory note secured by a mortgage or deed of trust as to which a notice of default has been recorded pursuant to Section 2924 of the Civil Code or an action has been commenced pursuant to Section 725a of the Code of Civil Procedure.

(c) The depository may exercise, enforce, or waive any right granted to it by the promissory note, mortgage, or deed of trust.

(d) For purposes of this article, the market value of a promissory note which is an eligible security under subdivision (m) of Section 53651, shall be determined in accordance with the regulations adopted by the Treasurer under paragraph (2) of subdivision (m) of Section 53651, as

the regulations and statute were in effect on December 31, 1986. However, if and when regulations on the subject are adopted by the administrator, the market value shall be determined in accordance with those regulations of the administrator.

53651.4. (a) A depository that uses eligible securities of the class described in subdivision (m) of Section 53651 shall, within 90 days after the close of each calendar year or within a longer period

as the administrator may specify, file with the administrator a report of an independent certified public accountant regarding compliance with this article and with regulations and orders issued by the administrator under this article with respect to eligible securities of that class. The report shall be based upon the audit, shall contain the information, and shall be in the form the administrator may prescribe. The depository shall provide a copy of the report to the treasurer on request.

(b) If a depository that is a state bank files with the administrator, not less than 90 days before the beginning of the calendar year, a notice that it elects to be examined by the administrator instead of filing a report of an independent certified public accountant under subdivision (a) for that calendar year, the depository shall be exempt from subdivision (a) for that calendar year and shall for that calendar year be subject to examination by the administrator regarding compliance with this article and with regulations and orders under this article with respect to eligible securities of the class described in subdivision (m) of Section 53651. The administrator shall provide a report to a treasurer with deposits in the examined state bank upon request of the treasurer.

(c) A national bank may apply to the administrator to be examined, and the administrator, in his or her discretion, may examine a national bank for the purposes of satisfying the requirements of subdivision (a). The administrator shall provide a report to a treasurer with deposits in the examined national bank upon request of the treasurer.

(d) Whenever the administrator examines a depository pursuant to subdivision (b) or (c), the depository shall pay, within 30 days after receipt of a statement from the administrator, a fee of seventy-five dollars (\$75) per hour for each examiner engaged in the examination.

53651.6. (a) To be an eligible security under subdivision (p) of Section 53651, a letter of credit shall be in such form and shall contain such provisions as the administrator may prescribe, and shall include all of the following terms:

(1) The administrator shall be the beneficiary of the letter of credit.

(2) The letter of credit shall be clean and irrevocable and shall provide that the administrator may draw upon it up to the total amount in the event of the failure of the depository savings association or federal association or if the depository savings association or federal association refuses to permit the withdrawal of funds by a treasurer.

53652. To secure active or inactive deposits a depository shall at all times maintain with the agent of depository eligible securities in securities pools, pursuant to Sections 53656 and 53658, in the amounts specified in this section. Uncollected funds shall be excluded from the amount deposited in the depository when determining the security requirements for the deposits.

(a) Eligible securities, except eligible securities of the classes described in subdivisions (m) and (p) of Section 53651, shall have a market value of at least 10 percent in excess of the total amount of all deposits of a depository secured by the eligible securities.

(b) Eligible securities of the class described in subdivision (m) of Section 53651 shall have a market value at least 50 percent in excess of the total amount of all deposits of a depository secured by those eligible securities.

(c) Eligible securities of the class described in subdivision (p) of Section 53651 shall have a market value of at least 5 percent in excess of the total amount of all deposits of a depository secured by those eligible securities. For purposes of this article, the market value of a letter of credit which is an eligible security under subdivision (p) of Section 53651 shall be the amount of credit stated in the letter of credit.

53653. When in his or her discretion local conditions so warrant, the treasurer may waive security for the portion of any deposits as is insured pursuant to federal law, notwithstanding this article. For deposits equivalent to and not less than the maximum amount insured pursuant to federal law for which a treasurer has waived security under this section, a treasurer at his or her discretion may also waive security for the interest accrued on the deposits which, when added to the deposits, would cause the sum of the interest and deposits to exceed the maximum amount insured pursuant to federal law, provided that the interest is computed by the depository on the average daily balance of the deposits, paid monthly and computed on a 360-day basis.

53654. (a) The depository may add securities to the pool or substitute securities of equal value for those in the pool at any time, but shall not interchange classes of security, as defined in Section 53632.5, without prior approval of the treasurer.

(b) Withdrawal of securities from the pool without replacement at equal value may be ordered only by two duly authorized officers or employees of the depository who satisfy the requirements as may be set by the administrator.

(c) The agent of depository is responsible for the safekeeping and disbursement of securities placed in its custody by a depository. It shall release securities only upon presentation by the depository of the most reasonably current statement of the total deposits subject to this article held by the depository, such statement to be verified and countersigned by two duly authorized officers, other than those who ordered the withdrawal of securities. A copy of this statement shall be forwarded to the administrator concurrently by the agent of depository.

53655. A placement of securities by a depository with an agent of depository pursuant to this article shall have the effect of perfecting a security interest in those securities in the local agencies having deposits in that depository notwithstanding provisions of the Uniform Commercial Code to the contrary and notwithstanding that the agent of depository may be the trust department of the depository.

53656. (a) At the time the treasurer enters into a contract with the depository pursuant to Section 53649, he or she shall authorize the agent of depository designated by the depository, but including the trust department of the depository only when acceptable to both the treasurer and the depository, to hold securities of the depository in accordance with this article to secure the deposit of the local agency.

(b) Only those trust companies and trust departments, or the Federal Home Loan Bank of San Francisco, which have been authorized by the administrator pursuant to Section 53657 shall be authorized by treasurers to act as agents of depository.

(c) The securities are subject to order of the depository in accordance with Section 53654 except when the provisions of subdivision (i) of Section 53661 and Section 53665 are in effect.

(d) An agent of depository shall not release any security held to secure a local agency deposit in a depository unless the administrator issues an order authorizing the release where either of the following occurs:

(1) A state or federal regulatory agency has taken possession of the depository.

(2) A conservator, receiver, or other legal custodian has been appointed for the depository.

53657. (a) No person shall act as an agent of depository unless that person is a trust company located in this state, the trust department of a bank located in this state, or the Federal Home Loan Bank of San Francisco, and is authorized by the administrator to act as an agent of depository.

(b) (1) An application for authorization shall be in such form, shall contain such information, shall be signed in such manner, and shall (if the administrator so requires) be verified in such manner, as the administrator may prescribe.

(2) The fee for filing an application for authorization with the administrator shall be five hundred dollars (\$500).

(3) If the administrator finds, with respect to an application for authorization, that the applicant is competent to act as an agent of depository and that it is reasonable to believe the applicant will comply with all applicable provisions of this article and of any regulation or order issued under this article, the administrator shall approve the application. If the administrator finds otherwise, the administrator shall deny the application.

(4) When an application for authorization has been approved, the applicant shall file with the administrator an agreement to comply with all applicable provisions of this article and of any regulation or order issued under this article. The agreement shall be in such form, shall contain such provisions, and shall be signed in such manner as the administrator may prescribe.

(5) When an application for authorization has been approved, the applicant has complied with paragraph (4), and all conditions precedent to authorizing the applicant to act as agent of depository have been fulfilled, the administrator shall authorize the applicant to act as agent of depository.

53658. An agent of a depository may hold and pool securities to secure deposits for one or more depositories pursuant to Section 53656, but shall maintain a separate pool for each said depository. Each local agency shall have an undivided security interest in the pooled securities in the proportion that the amount of its deposits bears to the total amount of deposits secured by the pooled securities.

53659. Whenever an agent of depository accepts securities pursuant to Section 53656 it may, with the authorization of the depository, place such securities for safekeeping with a Federal Reserve Bank or branch thereof or with any bank located in a city designated as a reserve city by the Board of Governors of the Federal Reserve System or with the Federal Home Loan Bank of San Francisco or with a trust company located in this state. Authority for such placement together with the names of the banks or, including the Federal Home Loan Bank of San

Francisco, trust companies to be so used, shall be contained in the contract between the treasurer and the depository required in Section 53649.

53660. When deposits of a local agency are secured by pooled securities pursuant to Section 53656, the agent of depository shall make available to the treasurer for review at a mutually agreed upon time and location all of the following information which may be in the form of a copy of the report required in subdivision (e) of Section 53661:

(a) A certification that there are securities in the pool in the amounts required by Section 53652 to secure deposits.

(b) A certified report of the individual securities then on deposit in the pool with the location and total market value thereof.

(c) The total amount of deposits then reported by the depository to be secured by the pool.

53661. (a) The Commissioner of Financial Institutions shall act as Administrator of Local Agency Security and shall be responsible for the administration of Sections 53638, 53651, 53651.2, 53651.4, 53651.6, 53652, 53654, 53655, 53656, 53657, 53658, 53659, 53660, 53661, 53663, 53664, 53665, 53666, and 53667.

(b) The administrator shall have the powers necessary or convenient to administer and enforce the sections specified in subdivision (a).

(c) (1) The administrator shall issue regulations consistent with law as the administrator may deem necessary or advisable in executing the powers, duties, and responsibilities assigned by this article. The regulations may include regulations prescribing standards for the valuation, marketability, and liquidity of the eligible securities of the class described in subdivision (m) of Section 53651, regulations prescribing procedures and documentation for adding, withdrawing, substituting, and holding pooled securities, and regulations prescribing the form, content, and execution of any application, report, or other document called for in any of the sections specified in subdivision (a) or in any regulation or order issued under any of those sections.

(2) The administrator, for good cause, may waive any provision of any regulation adopted pursuant to paragraph (1) or any order issued under this article, where the provision is not necessary in the public interest.

(d) The administrator may enter into any contracts or agreements as may be necessary, including joint underwriting agreements, to sell or liquidate eligible securities securing local agency deposits in the event of the failure of the depository or if the depository fails to pay all or part of the deposits of a local agency.

(e) The administrator shall require from every depository a report certified by the agent of depository listing all securities, and the market value thereof, which are securing local agency deposits together with the total deposits then secured by the pool, to determine whether there is compliance with Section 53652. These reports may be required whenever deemed necessary by the administrator, but shall be required at least four times each year at the times designated by the Comptroller of the Currency for reports from national banking associations. These reports shall be filed in the office of the administrator by the depository within 20 business days of the date the administrator calls for the report.

(f) The administrator may have access to reports of examination made by the Comptroller of the Currency insofar as the reports relate to national banking association trust department activities which are subject to this article.

(g) (1) The administrator shall require the immediate substitution of an eligible security, where the substitution is necessary for compliance with Section 53652, if (i) the administrator determines that a security listed in Section 53651 is not qualified to secure public deposits, or (ii) a treasurer, who has deposits secured by the securities pool, provides written notice to the administrator and the administrator confirms that a security in the pool is not qualified to secure public deposits.

(2) The failure of a depository to substitute securities, where the administrator has required the substitution, shall be reported by the administrator promptly to those treasurers having money on deposit in that depository and, in addition, shall be reported as follows:

(A) When that depository is a national bank, to the Comptroller of the Currency of the United States.

(B) When that depository is a state bank, to the Commissioner of Financial Institutions.

(C) When that depository is a federal association, to the Office of Thrift Supervision.

(D) When that depository is a savings association, to the Commissioner of Financial Institutions.

(E) When that depository is a federal credit union, to the National Credit Union Administration.

(F) When that depository is a state credit union or a federally insured industrial loan company, to the Commissioner of Financial Institutions.

(h) The administrator may require from each treasurer a registration report and at appropriate times a report stating the amount and location of each deposit together with other information deemed necessary by the administrator for effective operation of this article. The facts recited in any report from a treasurer to the administrator are conclusively presumed to be true for the single purpose of the administrator fulfilling responsibilities assigned to him or her by this article and for no other purpose.

(i) (1) If, after notice and opportunity for hearing, the administrator finds that any depository or agent of depository has violated or is violating, or that there is reasonable cause to believe that any depository or agent of depository is about to violate, any of the sections specified in subdivision (a) or any regulation or order issued under any of those sections, the administrator may order the depository or agent of depository to cease and desist from the violation or may by order suspend or revoke the authorization of the agent of depository. The order may require the depository or agent of depository to take affirmative action to correct any condition resulting from the violation.

(2) (A) If the administrator makes any of the findings set forth in paragraph (1) with respect to any depository or agent of depository and, in addition, finds that the violation or the continuation of the violation is likely to seriously prejudice the interests of treasurers, the administrator may order the depository or agent of depository to cease and desist from the violation or may suspend or revoke the authorization of the agent of depository. The order may require the depository or agent of depository to take affirmative action to correct any condition resulting from the violation.

(B) Within five business days after an order is issued under subparagraph (A), the depository or agent of depository may file with the administrator an application for a hearing on the order. The

administrator shall schedule a hearing at least 30 days, but not more than 40 days, after receipt of an application for a hearing or within a shorter or longer period of time agreed to by a depository or an agent of depository. If the administrator fails to schedule the hearing within the specified or

agreed to time period, the order shall be deemed rescinded. Within 30 days after the hearing, the administrator shall affirm, modify, or rescind the order; otherwise, the order shall be deemed rescinded. The right of a depository or agent of depository to which an order is issued under subparagraph (A) to petition for judicial review of the order shall not be affected by the failure of the depository or agent of depository to apply to the administrator for a hearing on the order pursuant to this subparagraph.

(3) Whenever the administrator issues a cease and desist order under paragraph (1) or (2), the administrator may in the order restrict the right of the depository to withdraw securities from a security pool; and, in that event, both the depository to which the order is directed and the agent of depository which holds the security pool shall comply with the restriction.

(4) In case the administrator issues an order under paragraph (1) or (2) suspending or revoking the authorization of an agent of depository, the administrator may order the agent of depository at its own expense to transfer all pooled securities held by it to such agent of depository as the administrator may designate in the order. The agent of depository designated in the order shall accept and hold the pooled securities in accordance with this article and regulations and orders issued under this article.

(j) In the discretion of the administrator, whenever it appears to the administrator that any person has violated or is violating, or that there is reasonable cause to believe that any person is about to violate, any of the sections specified in subdivision (a) or any regulation or order issued thereunder, the administrator may bring an action in the name of the people of the State of California in the superior court to enjoin the violation or to enforce compliance with those sections or any regulation or order issued thereunder. Upon a proper showing a permanent or preliminary injunction, restraining order, or writ of mandate shall be granted, and the court may not require the administrator to post a bond.

(k) In addition to other remedies, the administrator shall have the power and authority to impose the following sanctions for noncompliance with the sections specified in subdivision (a) after a hearing if requested by the party deemed in noncompliance. Any fine assessed pursuant to this subdivision shall be paid within 30 days after receipt of the assessment.

(1) Assess against and collect from a depository a fine not to exceed two hundred fifty dollars (\$250) for each day the depository fails to maintain with the agent of depository securities as required by Section 53652.

(2) Assess against and collect from a depository a fine not to exceed one hundred dollars (\$100) for each day beyond the time period specified in subdivision (b) of Section 53663 the depository negligently or willfully fails to file in the office of the administrator a written report required by that section.

(3) Assess against and collect from a depository a fine not to exceed one hundred dollars (\$100) for each day beyond the time period specified in subdivision (e) that a depository negligently or willfully fails to file in the office of the administrator a written report required by that subdivision.

(4) Assess and collect from an agent of depository a fine not to exceed one hundred dollars (\$100) for each day the agent of depository fails to comply with any of the applicable sections specified in subdivision (a) or any applicable regulation or order issued thereunder.

(l) (1) In the event that a depository or agent of depository fails to pay a fine assessed by the administrator pursuant to subdivision (k) within 30 days of receipt of the assessment, the administrator may assess and collect an additional penalty of 5 percent of the fine for each month or part thereof that the payment is delinquent.

(2) If a depository fails to pay the fines or penalties assessed by the administrator, the administrator may notify local agency treasurers with deposits in the depository.

(3) If an agent of depository fails to pay the fines or penalties assessed by the administrator, the administrator may notify local agency treasurers who have authorized the agent of depository as provided in Sections 53649 and 53656, and may by order revoke the authorization of the agent of depository as provided in subdivision (i).

(m) The amendments to this section enacted by the Legislature during the 1999-2000 Regular Session shall become operative on January 1, 2001.

53663. (a) Each agent of depository shall report in writing to the administrator within two business days after any withdrawal, substitution or addition of pooled securities and shall state the name and market value of the securities withdrawn, substituted or added together with the total deposits then secured by the pool. This information shall be available from the administrator to the treasurer upon request.

(b) Each depository shall report in writing to the administrator weekly, giving the total amount of all deposits held by such depository pursuant to this article. Such report shall be as of close of business on Wednesday of each week and shall be delivered to the office of the administrator or deposited in the United States mail, postage prepaid, addressed to the office of the administrator, within five business days. Where there has occurred no change in the deposits required to be held by the depository pursuant to this article, the report required by this subdivision need only state that fact.

53664. The individual reports specified in Sections 53654, 53660, 53661, and 53663 are not public documents and are not open to inspection by the public.

53665. If a depository fails to pay all or part of the deposits of a local agency secured by pooled securities in accordance with the contract provided for in Section 53649, and on demand of its treasurer or other authorized official and the treasurer files a report with the administrator, or if the depository fails:

(a) In case the pooled securities consist of securities other than securities of the class described in subdivision (p) of Section 53651, the administrator shall order the agent of depository holding the pooled securities to convert into money that portion of the pooled securities necessary to produce an amount equal to the sum of (i) the deposits of the local agency, (ii) any accrued interest due on the deposits, and (iii) the reasonable expenses of the agent of depository in complying with the order of the administrator and to pay the sum of items (i) and (ii) to the treasurer in satisfaction of the deposits. The agent of depository shall be reimbursed out of the proceeds of the conversion for its reasonable expenses in complying with the order of the administrator, as approved by the administrator. Any excess moneys resulting from the conversion shall be retained by the agent of depository as part of the securities pool until the depository substitutes for the excess moneys securities having a market value sufficient to bring the total of pooled securities up to the amount required by Section 53652.

(b) In case the pooled securities consist of a security of the class described in subdivision (p) of Section 53651, the administrator shall draw on the letter of credit an amount equal to the sum of (i) the deposits of the local agency, (ii) any accrued interest on the deposits, and (iii) the reasonable expenses of the administrator in paying the deposits and pay the sum of items (i) and (ii) to the treasurer in satisfaction of the deposits.

53666. The only liability that shall attach to the administrator as the result of the operation of this article is that which would attach as a result of other laws of this state.

53667. (a) Expenses incurred by the administrator in carrying out the duties and responsibilities assigned to the administrator by the sections specified in subdivision (a) of Section 53661, shall be borne by the Local Agency Deposit Security Fund, which is hereby created and continuously appropriated to the administrator for the administration of the sections specified in subdivision (a) of Section 53661. This fund shall consist of fines levied pursuant to Section 53661, fees collected pursuant to the sections specified in subdivision (a) of Section 53661, and assessments levied pursuant to this section.

(b) Each fiscal year the administrator shall levy an assessment on a pro rata basis on those depositories which at any time during the preceding fiscal year held local agency deposits. The total assessment levied on all of those depositories shall be in an amount which, when added to the amount of fines and fees that the administrator estimates will be collected during the fiscal year when the assessment is levied, is sufficient in the judgment of the administrator to meet the expenses of the administrator in administering the sections specified in subdivision (a) of Section 53661 and to provide a reasonable reserve for contingencies. The basis of the apportionment of the assessment among the depositories assessed shall be the proportion that the average amount of local agency deposits held by each of those depositories bears to the average total amount of local agency deposits held by all of those depositories as shown by the reports of depositories to the administrator for the preceding fiscal year, as required in subdivision (e) of Section 53661; provided, however, that the amount of the assessment levied on each of those depositories shall be not less than twenty-five dollars (\$25).

(c) The administrator shall notify each depository by mail of the amount levied against it. The depository shall pay the amount levied within 20 days after such notice into the Local Agency Deposit Security Fund for the administration of the sections specified in subdivision (a) of Section 53661. If payment is not made to the administrator within such time, the administrator shall assess and collect, in addition to the annual assessment, a penalty of 5 percent of the assessment for each month or part thereof that the payment is delinquent. If a depository fails to pay the assessment or penalties assessed by the administrator, the administrator may notify local agency treasurers with deposits in the depository.

53669. The treasurer or other authorized official is not responsible for money while it is deposited pursuant to this article.

53676. The treasurer is not responsible for securities delivered to and receipted for by any bank, savings and loan association, credit union, federally insured industrial loan company, or trust company.

53678. The charges for the handling and safekeeping of any such securities are not a charge against the treasurer but shall be paid by the depository owning the securities.

53679. So far as possible, all money belonging to a local agency under the control of any of its officers or employees other than the treasurer or a judge or officer of a municipal court shall, and all money coming into the possession of a judge or officer of a municipal court may, be deposited as active deposits in the state or national bank, inactive deposits in the state or national

bank or state or federal association, federal or state credit union, or federally insured industrial loan company in this state selected by the officer, employee, or judge of the court. For purposes of this section, an officer or employee of a local agency and a judge or officer of a municipal court are prohibited from depositing local agency funds or money coming into their possession into a state or federal credit union if an officer or employee of the local agency, or a judge or officer of a municipal court, also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or supervisory committee, of the particular state or federal credit union. Such money is subject to this article except:

(a) Deposits in an amount less than that insured pursuant to federal law are not subject to this article.

For deposits in excess of the amount insured under any federal law a contract in accordance with Section 53649 is required and the provisions of this article shall apply.

(b) Interest is not required on money deposited in an active deposit by a judge or officer of a municipal court.

(c) Interest is not required on money deposited in an active deposit by an officer having control of a revolving fund created pursuant to Chapter 2 (commencing with Section 29300) of Division 3 of Title 3.

(d) Interest is not required on money deposited in an active deposit by an officer having control of a special fund established pursuant to Articles 5 (commencing with Section 29400) or 6 (commencing with Section 29430) of Chapter 2 of Division 3 of Title 3.

53679.1. Notwithstanding any other provision of law, the accounting practices of each county utilized prior to the effective date of this section relating to interest on trust funds shall be deemed appropriate and to have been made under the direction of the board of supervisors of that county. This section is declaratory of the law in existence prior to the enactment of this section.

53680. A tax collector of a local agency shall immediately deposit with the treasurer all money under his control, unless he deposits the money in a depository pursuant to this article under permission and instructions of the treasurer having authority to make such deposit.

53681. An officer or employee of a local agency who deposits money belonging to, or in the custody of, the local agency in any other manner than that prescribed in this article is subject to forfeiture of his office or employment.

53682. Notwithstanding any other provision in this article except Section 53652, the treasurer may deposit moneys in and enter into contracts with any depository, as defined in subdivision (c) of Section 53630, for services to be rendered by that depository that in the treasurer's judgment are to the public advantage. One copy of each contract entered into under this section shall be filed with the auditor or corresponding officer of the local agency. The contract shall:

- (a) Fix the duration of compensating deposits, if any.
- (b) Fix the interest rate of that compensating deposit, if any.
- (c) Specify the services to be rendered by the depository.
- (d) Indicate whether the depository shall bear the expenses of transportation of the money to and from the depository.
- (e) Fix the consideration payable by the agency for such services.
- (f) Specify who may deposit moneys into the treasurer's active account and how those persons are to make those deposits.

53683. Notwithstanding any other provision in this article, the consideration payable by the agency as specified in subdivision (e) of Section 53682 shall be paid by the treasurer by applying such consideration as costs applied on a pro rata basis against the interest earned by all the agencies for which the treasurer invests.

53684. (a) Unless otherwise provided by law, if the treasurer of any local agency, or other official responsible for the funds of the local agency, determines that the local agency has excess funds which are not required for immediate use, the treasurer or other official may, upon the adoption of a resolution by the legislative or governing body of the local agency authorizing the investment of funds pursuant to this section and with the consent of the county treasurer, deposit the excess funds in the county treasury for the purpose of investment by the county treasurer pursuant to Section 53601 or 53635.

(b) The county treasurer shall, at least quarterly, apportion any interest or other increment derived from the investment of funds pursuant to this section in an amount proportionate to the average daily balance of the amounts deposited by the local agency and to the total average daily balance of deposits in the investment pool. In apportioning and distributing that interest or increment, the county treasurer may use the cash method, the accrual method, or any other method in accordance with generally accepted accounting principles. Prior to distributing that interest or increment, the county treasurer may deduct the actual costs incurred by the county in administering this section in proportion to the average daily balance of the amounts deposited by the local agency and to the total average daily balance of deposits in the investment pool.

(c) The county treasurer shall disclose to each local agency that invests funds pursuant to this section the method of accounting used, whether cash, accrual, or other, and shall notify each local agency of any proposed changes in the accounting method at least 30 days prior to the date on which the proposed changes take effect.

(d) The treasurer or other official responsible for the funds of the local agency may withdraw the funds of the local agency pursuant to the procedure specified in Section 27136.

(e) Any moneys deposited in the county treasury for investment pursuant to this section are not subject to impoundment or seizure by any county official or agency while the funds are so deposited.

(f) This section is not operative in any county until the board of supervisors of the county, by majority vote, adopts a resolution making this section operative in the county.

(g) It is the intent of the Legislature in enacting this section to provide an alternative procedure to Section 51301 for local agencies to deposit money in the county treasury for investment purposes. Nothing in this section shall, therefore, be construed as a limitation on the authority of a county and a city to contract for the county treasurer to perform treasury functions for a city pursuant to Section 51301.

53686. (a) Any audit conducted relating to the investment of local agency funds and other funds by the county treasurer in the county fund maintained pursuant to Section 53684 shall be rendered to the depository, the auditor, the controller, the secretary, or the corresponding officer of the local agency, the treasurer or other official responsible for the funds of any local agency that has funds on deposit in the county treasury, and the presiding judge of any superior court that has ordered, pursuant to Section 3412, Section 3413, or Section 3611 of the Probate Code, that assets of an estate be deposited with the county treasurer for deposit or investment.

(b) Any report rendered pursuant to Section 53646 shall be provided to the treasurer or other official responsible for the funds of any local agency that has funds on deposit in the county treasury.

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